# TRANSCRIPT OF RECORD

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## SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1961

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No. 190

UNITED STATES, PETITIONER,

vs.

THOMAS CRAWLEY DAVIS, ET AL.

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No. 268

THOMAS CRAWLEY DAVIS, ET AL., PETITIONERS,

vs.

UNITED STATES

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

No. 190—PETITION FOR CERTIORARI FILED JUNE 29, 1961
No. 268—PETITION FOR CERTIORARI FILED JULY 28, 1961

CERTIORARI GRANTED OCTOBER 9, 1961

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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# IN THE UNITED STATES COURT OF CLAIMS

Docket No. 516-58

Thomas Crawley Davis and Grace Ethel Davis, Plaintiffs,

v.

United States of America, Defendant

Petition—Filed November 25, 1958

To the Honorable United States Court of Claims:

The petition of the plaintiffs, Thomas Crawley Davis and Grace Ethel Davis, respectfully shows:

1. At the end of the calendar year 1955, the plaintiffs, Thomas Crawley Davis and Grace Ethel Davis, were husband and wife. Said plaintiffs are citizens of the United States, and their mailing address is Room 9016 duPont Building, Wilmington, Delaware.

2. This claim arises under the internal revenue laws of the United States to recover income tax and interest erroneously and illegally collected by and on behalf of the defendant by the duly appointed, qualified and acting District Director of Internal Revenue for Delaware.

3. On or before April 15, 1956, plaintiffs Thomas Crawley Davis and Grace Ethel Davis filed a 1955 joint federal income tax return with the District Director of Internal Revenue for Delaware. Such return showed taxable income of $276,374.43 and net tax payable of $202,014.52. The latter amount was duly paid on or before April 15, 1956.

[fol. 3] 4. Plaintiff Thomas Crawley Davis and Alice M. Davis were married on March 1, 1941. Towards the end of 1953, the relations between plaintiff Thomas Crawley Davis and Alice M. Davis became quite strained, and Alice M. Davis began to make demands on plaintiff Thomas Crawley Davis that he deliver to her one-half of the approximately 3,000 shares of E. I. duPont deNemours Company herein-after "duPont") common stock held by him.

5. In December 1953, plaintiff Thomas Crawley Davis was elected a member of the board of directors and of the executive committee of duPont. At the same time, plaintiff

Thomas Crawley Davis was named a vice president of duPont. At the time of his election to the board and executive committee, plaintiff Thomas Crawley Davis' stock holdings in duPont were substantially less than those of any other director. There was no precedent in duPont for the election of a director and member of the executive committee of a person with stock holdings as small as those of plaintiff Thomas Crawley Davis. Accordingly, plaintiff Thomas Crawley Davis became convinced that a transfer to Alice M. Davis of one-half of his duPont stock pursuant to her demands would seriously jeopardize his position as a member of the board and executive committee and as a vice president of duPont.

6. For the calendar year 1954, plaintiff Thomas Crawley Davis' adjusted gross income amounted to $264,984, of which $258,022 (or over 97%) represented salary and directors' fees from duPont and dividends on duPont stock. For the calendar year 1955, plaintiff Thomas Crawley Davis' adjusted gross income amounted to $317,865, of which $317,745 (or over 99%) represented salary and directors' fees from duPont and dividends on duPont stock.

7. Plaintiff Thomas Crawley Davis believed that any substantial depletion of his stock interest in duPont would seriously and adversely affect his position with, and his income from, duPont not only during the period of his [fol. 4] active participation in the affairs of duPont, but also in the period following his retirement.

8. In the early part of 1954, Alice M. Davis retained James R. Morford, Esquire, a member of the law firm of Morford and Bennethum, of Wilmington, Delaware, to represent her in negotiations with plaintiff Thomas Crawley Davis. Initially, plaintiff Thomas Crawley Davis declined to retain an attorney to represent him in this matter. However, by late summer of 1954, it became obvious to plaintiff Thomas Crawley Davis that his attempts at reconciliation were futile and he retained H. Albert Young, Esquire, a member of the law firm of Young and Wood of Wilmington, Delaware, in an attempt to work out a satisfactory property settlement with Alice M. Davis.

9. Alice M. Davis, throughout the initial negotiations between the parties' respective counsel, remained adamant in her demand that plaintiff Thomas Crawley Davis deliver to her, *inter alia*, one-half of his shares of duPont stock

and Plaintiff Thomas Crawley Davis resisted these demands. Following negotiations between the parties' respective counsel, plaintiff Thomas Crawley Davis and Alice M. Davis, on November 4, 1954, executed a separation agreement. A copy of the parts of that agreement pertinent to this proceeding is attached hereto as Exhibit A, and is hereinafter referred to as the "separation agreement."

10. In the separation agreement, the parties made provision for the settlement of their respective interests and demands in connection with property held by the parties and for a division of such properties. Under paragraph 3 of the separation agreement, in connection with the property division, plaintiff Thomas Crawley Davis agreed to deliver to Alice M. Davis 1,000 shares of duPont common stock, of which 500 shares were to be delivered on April 1, 1955, and the balance on April 1, 1956.

[fol. 5] 11. The separation agreement, in addition to making provision for the division of the parties' property, provided in paragraph 5 thereof for payments to Alice M. Davis in discharge of plaintiff Thomas Crawley Davis' obligations of maintenance and support.

12. Attached hereto as Exhibit B is a schedule listing the shares of duPont stock transferred to Alice M. Davis by plaintiff Thomas Crawley Davis during 1955 in accordance with the terms of the separtion agreement.

13. During 1955, plaintiff Thomas Crawley Davis paid to Young and Wood, Esquires, of Wilmington, Delaware, and Morford and Bennethum, Esquires, of Wilmington, Delaware, legal fees as follows:

| Item | Description of services as set forth in attorneys' statement | Payee | Amount | Date |
|---|---|---|---|---|
| 1. | Tax matters in the case of Davis v. Davis | Young & Wood | $2,500 00 | 1-27-55 |
| 2. | Professional services rendered in connection with tax matters involved in the matter of Alice M. Davis versus T. Crawley Davis | Morford & Bennethum | 2,500 00 | 1-27-55 |
| 3. | Separation agreement and property division between T. C. Davis and Alice M. Davis | Young & Wood | 5,006 00 | 1-27-55 |
| 4. | Professional services in the matter of division of property and the preparation of separation agreement between T. Crawley Davis and Alice M. Davis | Morford & Bennethum | 2,500 00 | 1-27-55 |

14. Plaintiffs Thomas Crawley Davis and Alice M. Davis were granted an absolute divorce by a decree of the Second Judicial District Court of the State of Nevada in and for [fol. 6] the County of Washoe on January 5, 1955. Said decree incorporated and approved the property division provided in the separation agreement mentioned in paragraph 9 hereof.

15. In the 1955 joint federal income tax return filed by plaintiffs, they claimed as deductions legal fees in the amount of $5,000 representing payments during 1955 for legal services in connection with tax matters associated with the negotiation of the separation agreement, being the services described in items 1 and 2 in paragraph 13 hereof.

16. In connection with the audit of plaintiffs' federal income tax return for the year 1955, representatives of the United States Internal Revenue Service proposed to assess a deficiency in the amount of $6,318.66 on the basis of the disallowance as a deduction of $5,000 of legal fees in connection with tax matters (as mentioned in paragraph 15 hereof) and on the basis of including in plaintiffs' gross income net long-term capital gain of $3,737.31, representing the difference between the tax basis to plaintiff Thomas Crawley Davis of 500 shares of duPont stock transferred to Alice M. Davis during 1955 and the fair market value of such shares as of the date of transfer to Alice M. Davis.

17. On February 14, 1958, plaintiff Thomas Crawley Davis paid to the District Director of Internal Revenue for Delaware the amount of $6,961.95, representing the asserted deficiency in 1955 federal income tax in the amount of $6,318.66 plus interest of $643.29.

18. On April 7, 1958, plaintiffs filed with the District Director of Internal Revenue for Delaware a claim for refund of $13,642.29 of 1955 federal income tax and deficiency interest mentioned in paragraph 17 based upon an overpayment of such tax resulting from the failure of the United States Internal Revenue Service to allow as a deduction legal fees in the amount of $12,506 as described in paragraph 13 above pursuant to the provisions of section 212 [fols. 7-19] of the Internal Revenue Code of 1954 and from the erroneous inclusion in the gross income of plaintiffs of long-term capital gain resulting from the transfer of 500 shares of duPont stock from plaintiff Thomas Crawley

Davis to Alice M. Davis. A copy of said claim for refund is attached hereto as Exhibit C.

19. By registered mail letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified plaintiffs of disallowance in full of their claim for refund for the year 1955.

20. No action on this claim other than that set forth herein has been taken before Congress or in any department of the government of the United States or in any court. The plaintiffs are the sole owners of this claim and no part of this claim has ever been assigned or transferred. The plaintiffs believe the facts stated herein to be true.

21. The defendant owes the plaintiffs $13,642.29 plus interest thereon as provided by law.

WHEREFORE, plaintiffs demand judgment against the defendant for the sum of $13,642.29 with interest thereon as provided by law and costs and disbursements of this proceeding.

Respectfully submitted, Kenneth W. Gemmill, Converse Murdoch, Attorneys for Plaintiffs, 1600 Three Penn Center Plaza, Philadelphia 2, Pennsylvania.

November 20, 1958

Barnes, Dechert, Price, Myers & Rhoads, 1600 Three Penn Center Plaza, Philadelphia 2, Pennsylvania, of Counsel.

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[fol. 20] IN THE UNITED STATES COURT OF CLAIMS

No. 516-58

[Title omitted]

ANSWER—Filed January 23, 1959

The defendant, the United States of America, by its attorney, Charles K. Rice, Assistant Attorney General, answering the allegations in plaintiffs' petition herein:

I

Denies the allegations of such petition not admitted, qualified or otherwise specifically referred to below.

II

Further answering the petition, defendant—

1. Admits the allegations contained in paragraph 1.

[fol. 21] 2. Denies the allegations contained in paragraph 2, except that it admits that this claim arises under the internal revenue laws of the United States and admits that the District Director of Internal Revenue for Delaware was duly appointed, qualified and acting.

3. Admits the allegations contained in paragraph 3.

4. Is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 4.

5. Is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 5.

6. Is without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 6, except that it admits that for the calendar year 1955, plaintiff, Thomas Crawlew Davis's adjusted gross income amounted to $317,862, of which over 99% represented salary and directors' fees from duPont and dividends on duPont stock. The defendant avers that the salary, directors' fees and dividends referred to amounted to $317,727.

7. Is without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 7.

8. Is without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 8.

9. Is without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 9, except that it admits that a copy of parts of a [fol. 22] separation agreement is attached to the petition as Exhibit A and is referred to as the "separation agreement" in the petition.

10. Neither admits nor denies the allegations contained in paragraph 10 inasmuch as the separation agreement speaks for itself.

11. Neither admits nor denies the allegations contained in paragraph 11 inasmuch as the separation agreement speaks for itself.

12. Is without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 12, except that it admits that a schedule is attached to the petition as Exhibit B.

13. Is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 13.

14. Is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 14.

15. Is without information or knowledge sufficient to form a belief as to the truth of the allegations contained in paragraph 15, except that it admits that in the 1955 joint federal income tax return filed by plaintiffs they claimed as deductions legal fees in the amount of $5,000.

16. Admits the allegations contained in paragraph 16.

17. Admits the allegations contained in paragraph 17.

18. Denies the allegations contained in paragraph 18, except that it admits that on April 8, 1958, plaintiffs filed [fol. 23] with the District Director of Internal Revenue for Delaware a claim for refund of $13,642.29 of 1955 federal income tax and deficiency interest, and further admits that a copy of said claim for refund is attached to the petition as Exhibit C. The defendant also avers that it denies each and every allegation contained in said claim for refund not herein otherwise admitted.

19. Admits the allegations contained in paragraph 19.

20. Is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in paragraph 20.

21. Denies the allegations contained in paragraph 21.

Wherefore, the defendant, having answered fully, prays that the plaintiffs' action be dismissed with prejudice and that the defendant be awarded its costs and such other and further relief as to the Court may seem just and proper.

Charles K. Rice, Assistant Attorney General.

Peter J. Donahue, Attorney.

[fol. 24] [File endorsement omitted]

## In the United States Court of Claims

## Stipulation of Facts—Filed May 19, 1959

The parties to this proceeding, by their undersigned counsel, hereby stipulate that in addition to the facts already agreed to by virtue of the pleadings, the following shall be an agreed statement of facts subject to the right of either party to later object to the admissibility of such facts and to introduce other and further evidence not inconsistent herewith.

1. This claim arises under the internal revenue laws of the United States to recover income tax and interest collected by and on behalf of the defendant by the duly appointed, qualified, and acting District Director of Internal Revenue.

2. Plaintiff Thomas Crawley Davis and Alice M. Davis were married on March 1, 1941.

3. In December, 1953, plaintiff Thomas Crawley Davis was elected a member of the board of directors and of the executive committee of duPont. At the same time, plaintiff Thomas Crawley Davis was named a vice president of duPont.

[fol. 25] 4. For the calendar year 1954, plaintiff Thomas Crawley Davis' adjusted gross income amounted to $264,984, of which the following represented payments from duPont:

| | | |
|---|---|---|
| Salary | $87,437.48 | |
| Dividends treated as salary | 4,090.00 | |
| | | $ 91,527.48 |
| Bonus | | 152,705.97 |
| Directors' fees | | 550.00 |
| Dividends—duPont | | 13,239.02 |
| | | $258,022.47 |

For the calendar year 1955, plaintiff Thomas Crawley Davis' adjusted gross income amounted to $317,865, of which the following represented payments from duPont:

| | | |
|---|---|---|
| Salary | $90,600 00 | |
| Dividends treated as salary | 3,592 75 | |
| | | $ 94,192 75 |
| Bonus | | 208,016 27 |
| Directors' fees | | 500 00 |
| Dividends—duPont | | 15,036 00 |
| | | $317,745 02 |

5. In the early part of 1954, Alice M. Davis retained James R. Morford, Esquire, a member of the law firm of Morford and Bennethum, of Wilmington, Delaware, to represent her in negotiations with plaintiff Thomas Crawley Davis. In the summer of 1954, Thomas Crawley Davis retained H. Albert Young, Esquire, a member of the law firm of Young and Wood, of Wilmington, Delaware, in an attempt to work out a satisfactory property settlement with Alice M. Davis.

6. Following negotiations between the parties' respective counsel, plaintiff Thomas Crawley Davis and Alice M. Davis, on November 4, 1954, executed a separation agreement. A copy of the parts of that agreement pertinent to [fol. 26] this proceeding is attached to the petition in this proceeding as Exhibit A and is hereinafter referred to as the "Separation Agreement."

7. Attached to the petition in this proceeding as Exhibit B is a schedule listing the shares of duPont stock transferred to Alice M. Davis by plaintiff Thomas Crawley Davis on March 21, 1955, in accordance with the terms of the Separation Agreement.

8. During 1955, plaintiff Thomas Crawley Davis paid to Young and Wood, Esquires, of Wilmington, Delaware, and Morford and Bennethum, Esquires, of Wilmington, Delaware, legal fees as follows:

| Item | Payee | Amount | Date |
|---|---|---|---|
| 1. | Young and Wood | $2,500 00 | 1/27/55 |
| 2. | Morford and Bennethum | 2,500 00 | 1/27/55 |
| 3. | Young and Wood | 5,006 00 | 1/27/55 |
| 4. | Morford and Bennethum | 2,500 00 | 1/27/55 |

9. Plaintiff Thomas Crawley Davis and Alice M. Davis were granted an absolute divorce by a decree of the Second Judicial District Court of the State of Nevada in and for the County of Washoe on January , 1955. Said decree incorporated and approved the property division provided in the Separation Agreement mentioned in paragraph 7 hereof.

10. In the 1955 joint federal income tax return filed by plaintiffs, they claimed as deductions legal fees in the amount of $5,000.

11. No action on this claim other than that set forth herein has been taken before Congress or any other depart- [fol. 27-29] ment of the Government of the United States or in any court. The plaintiffs are the sole owners of this claim and no part of this claim has ever been assigned or transferred.

12. Plaintiff Thomas Crawley Davis' employment record with the duPont Company is as follows:

*November 16, 1934 to November 30, 1941*
Manager, Tax Division, Treasurer's Department
*December 1, 1941 to August 26, 1944*
Assistant Comptroller, Treasurer's Department
*August 27, 1944 to May 19, 1946*
Assistant Treasurer, Treasurer's Department
*May 20, 1946 to January 18, 1948*
First Assistant Treasurer, Treasurer's Department
*January 19, 1948 to December 20, 1953*
Treasurer of the Company
*December 21, 1953 to present time*
Member, Board of Directors
Member, Executive Committee
Vice President
*November 1, 1954 to present time*
Member, Finance Committee

13. Attached hereto as Exhibit A is a schedule showing plaintiff Thomas Crawley Davis' stockholdings in duPont as of February 28, 1953, and changes therein from that date to July 18, 1958.

Converse Murdoch, Attorney for Plaintiffs. Charles K. Rice, Assistant Attorney General. By: Peter J. Donahue, Attorney.

[fol. 30] IN THE UNITED STATES COURT OF CLAIMS

[Title omitted]

SUPPLEMENTAL STIPULATION OF FACTS—Filed July 20, 1959

The parties to this proceeding, by their undersigned counsel, hereby stipulate that in addition to the facts already agreed to by virtue of the pleadings and the previously filed stipulation of facts, the following shall be a supplemental agreed statement of facts subject to the right of either party to later object to the admissibility of such facts:

1. Exhibit A attached to this supplemental stipulation of facts is a statement of the principal assets and liabilities of plaintiff Thomas Crawley Davis as of July 1, 1954.

2. For the purpose of this case only, the parties agree that if Mrs. Alice Mahood (Alice M. Davis) were called as a witness by the defendant, she would testify in substance as follows:

[fols. 31-33] For a period of many years, the plaintiff Thomas Crawley Davis and his former wife, Alice M. Davis, had many disagreements of a personal nature, which finally led Alice M. Davis in 1954 to seek a separation. At that time, she asked that she be given approximately one-third of the plaintiff's property (including 1,500 shares of duPont stock) in order to provide for herself and her son in the future. Alice M. Davis' primary purpose in obtaining the separation was to sever the marital relationship which for personal reasons had not been successful.

The parties further agree that with the filing of this Supplemental Stipulation of Facts, the record may be closed since neither party proposes to introduce further evidence.

Converse Murdoch, Attorney for Plaintiffs. Charles K. Rice, Assistant Attorney General. By: Peter J. Donahue, Attorney.

[fols. 34-37] IN THE UNITED STATES COURT OF CLAIMS, WASHINGTON, D. C.

Docket No. 516-58

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS, Plaintiffs,

vs.

UNITED STATES OF AMERICA, Defendant

Wilmington, Delaware, April 30, 1959

Before: Honorable ROALD HOGENSON, Commissioner

**Transcript of Testimony**

APPEARANCES:

Barnes, Dechert, Price, Myers & Rhoads, of Counsel, 1600 Three Penn Center Plaza, Philadelphia 2, Pennsylvania. Converse Murdoch Esq., for the Plaintiffs.

Peter Donahue, Assistant United States Attorney, Department of Justice, Tax Division, Washington 25, D. C.

[fol. 38] Mr. Murdoch: Would it be helpful to you if I made a preliminary statement as to what this case is about?

The Commissioner: It is not necessary. I read the pleadings very carefully and I think I have a pretty good idea of them. If you wish to, you may do so however

Before we begin the record we shall swear the Reporter.

(The Reporter, Miss Elizabeth M. Brady, was sworn.)

The Commissioner: Now you may proceed.

Mr. Murdoch: The first issue in this case is the issue of whether Mr. Davis could deduct legal fees which he paid to Mr. Young and to Mr. Morford in 1955 for various services associated with a separation agreement between Mr. Davis and Alice M. Davis.

And the second issue bears only on the capital gains of the DuPont stock transferred for Mrs. Davis in connection with that separation agreement.

Mr. Morford, one of the two Attorneys to whom these fees were paid is not able to be here today. He is on trial

in an admiralty matter, but Mr. Young is here and I would like to have Mr. Young called first as a witness so he can get back to his office.

The Commissioner: All right, if you would like to, [fol. 39] proceed with the testimony.

Mr. Murdoch: Mr. Young, will you take the stand.

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H. ALBERT YOUNG ESQ., having been sworn, was examined and testified as follows:

Direct Examination.

By Mr. Murdoch:

Q. Mr. Young, will you state your address and occupation?

A. Bank of Delaware Building, Wilmington, Delaware; practicing Attorney in the State of Delaware.

Q. How long have you practiced law in Delaware?

A. Thirty years.

Q. And during those thirty years practice have you had experience in matters relating to marital separations and property divisions and divorce?

A. Yes.

Q. Were you retained by Mr. T. C. Davis to represent him in a marital matter in 1954?

A. Yes.

Q. Could you describe for us the nature of the controversy between Mr. Davis and his then wife, Alice M. Davis, and some of the problems you encountered in that?

A. Well I will try to be brief about it because in this case, as in all marital cases, there are so many details that one [fol. 40] ultimately forgets, that I can't recall all of the controversies that existed. But I do know that the substance of it was, when Mr. Davis came to my office, that there had been an agreement and that there was a consideration of separation and possibly ultimate divorce. But that Mr. Davis felt at that time that there may be some chance at reconciliation between his former wife and himself.

And our attention, or my attention and our office's atten-

tion at that time was directed towards affecting, if possible, such a consideration. James R. Morford, who was on the opposite side, represented Mrs. Davis. I might add parenthetically that now he is a partner of mine. He joined forces as of this year, January.

In discussing the matter with Mr. Morford, who in turn took it up with Mrs. Davis, we concluded that it was impossible to affect a reconciliation, so we proceeded with respect to settlement. And in that connection we were met with what we usually meet with all separation agreements, the Attorney acting as advocate for the wife wanted all that he could get, and we, acting on behalf of the husband, felt that we were being fair in what we offered, but we wanted to minimize what we could. And at first the wife, through her Counsel, Mr. Morford, demanded one half of all of Mr. Davis' holdings and particularly his stock holdings in DuPont which we consistently and adamantly refused.
[fol. 41] Finally, during the course of negotiations we agreed that Mr. Davis would transfer from his holdings 1,000 shares of DuPont common. But before we were going to make any offer with respect to the transfer of the 1,000 shares of common, we wanted to be sure about the tax consequences to Mr. Davis. That was one of the important features of this separation agreement.

In addition to that, Mr. Davis as I recall it and I may be incorrect, at that time I believe had just been elevated to the position of Vice-President. He had been Controller just before he came to my office. May I, off the record, ask——

The Commissioner: You are not sure about it?

Mr. Murdoch: We have a stipulation.

The Witness: At any rate, being a Director of the company, he was of the opinion that he should not transfer the substantial holdings in the DuPont Company, because every Director had at least some substantial holdings of the DuPont Company. And so we agreed, that is, unilaterally, that we would transfer 1,000 shares of DuPont, 500 at one time and 500 at another time. But it was all predicated upon the fact of how the tax impact would affect Mr. Davis.

And in that connection I want to say that this, unlike many other cases that I have handled in connecting with marital difficulties and separation agreements, either re-
[fol. 42] sulting ultimately in divorce or no divorce, I have

never had the problems posed to me as emphatically and as clearly as this particular matter with respect to the tax consequences. As a matter of fact we did considerable in the office—we did considerable research, and at that time the 1954 Code came out and we were first talking about the interpretation and rulings under the 1939 Act and I think very few people knew what was the impact of the 1954 Code.

So we had to bear in mind what would be the effect insofar as taxable income was concerned, what would be the effect with respect to capital gains and other related tax matters. This was as important to us from our side of the picture as it was to Mrs. Davis from her side of the picture, represented by Mr. Morford at that time.

One of the first matters (well it wasn't the very first) but among the first matters was a matter that was brought to my attention by the firm of Covington and Burling as to the impact of Section 2516.

Q. Excuse me, is that Covington and Burling a law firm?

A. A law firm in Washington, D.C. As to the effects of Section 2516 on the income tax and also as to its effect on—as a gift—and after receiving—after rather after inspecting the report from that firm, we were in constant communication with Mr. T. C. Davis as well as Mr. Morford representing Mrs. Davis.

[fol. 43] We also had to consider not only the transfer of stock and the property settlement that was being made between Mr. Davis and Mrs. Davis, but he was establishing a living trust for his son. We wanted to know what the tax consequences were with respect to that. We also had to put up some insurance in connection with our separation agreement and we wanted to know what the tax consequences were there also.

Mr. Donahue: If it please the Court, I will object to the witness continuing to ramble at his own free will. I think he should be required to answer specific questions.

Mr. Murdoch: I have a couple of questions.

The Commissioner: Very well.

Q. Were you aware during the course of your representation of Mr. Davis, that he had any particular knowledge of tax law which kept you on your toes, shall we say?

A. Yes.

Q. As to the tax aspects?

A. Yes, I felt that I had a client that was not only conscious of tax matters, but aware of what the impact of the 1954 Code was on this present situation, that is the separation agreement. I recall that one of the reasons leading [fol. 44] up to the disagreement between Mrs. Davis and himself was the fact that he spent so much time on behalf of the DuPont Company when he was Controller of the company, in separating or investigating the interests of DuPont in the United States from the Canadian outfit, and that great reliance was placed upon him by the DuPont Company, on his understanding of the tax consequences, and while he didn't know this particular one, he knew what it was—he put up the signal to us and the red light that we better be on our guard.

Q. In your discussion with Mr. Morford were you aware that he was likewise spending considerable time on this very matter in terms of discussing it, would you—

Mr. Donahue: I object to this qestion. I don't think this witness is qualified to answer as to what Mr. Morford did. That is something, if you want to bring that out Mr. Morford is the person. That is the rankest type of hearsay. I will object on that ground.

Mr. Murdoch: I am not asking how much Mr. Morford put in, I am asking if Mr. Morford in Mr. Young's presence devoted time as to discussions of this.

The Commissioner: Yes. That question is proper, you may answer that question as limited. That is within your own knowledge.

A. Yes. In my discussions with Mr. Morford we continually discussed the tax consequences with respect to the [fol. 45] property division. He in turn wanting to know whether it was going to have some effect on his client, and I in turn wanting to know what effect it was going to have on my client. As a matter of fact, that took up most of our time because the substance of the separation agreement had practically been resolved between Mr. and Mrs. Davis before they came to our office.

Q. Mr. Young, was there any Court proceedings in Delaware which you handled in connection with this matter?

A. None whatever.

Q. There was no separation action, no divorce action brought or abandoned, no Court action at all?

A. When you say action, Court, you mean Court action? There was a separation, this all resolved itself and it was released in the separation agreement.

Q. All your work went around the negotiation of this agreement?

A. That is right. I might add there was an ultimate divorce but not in Delaware.

Q. That is correct. Your services were not in connection with any Court action in divorce?

A. No, Counsel was engaged in Rice Rhodes in Reno, Nevada; he prepared all the papers. He attended to all the work.

Q. Based upon your experience as an Attorney in Dela- [fol. 46] ware for thirty years and experience in marital matters, would you express an opinion about the practice and law in Delaware regarding the husband's liability to pay a wife's Counsel fees?

Mr. Donahue: Objection to that opinion with respect to—with regard to the law because this Court can take judicial notice as to the law. The law speaks for itself. Objection to any opinion as to the custom in Delaware on the grounds it is a conclusion of the witness and we are after facts in this procedure, not conclusions.

The Commissioner: Would you concede that it is the general law that the husband in such circumstances pays the Attorney's fees for the wife's Attorney?

Mr. Donahue: No, your Honor, I would not concede that it is the law.

Mr. Murdoch: We are prepared to prove the law, and on argument, but I believe that it is proper for this witness to say on the basis of his experience what the practice has been in these matters.

Mr. Donahue: I still think that the witness in testifying as to what the practice is is giving his opinion, his conclusion as to what has been done. I don't think it is a fact.

Mr. Murdoch: I believe he can establish that the witness is an expert in this field, he is a practicing lawyer for thirty [fol. 47] years and I believe he is qualified to state.

The Commissioner: I have been a District Judge in the State and I know that there are numerous divorce cases

that never get beyond the trial stage, the trial Court stage. I know in my home State it was the common ordinary thing that the trial Judge awarded the wife's Attorney's fees for her representation in the divorce case. I don't think the reported decisions of the Appellate Courts would necessarily reflect such a practice. Therefore the objection is overruled and you may ask the question.

Q. You state what your knowledge is of the practice in Delaware in the husband's payment of Counsel fees?

A. The Court imposes a duty and obligation on the part of the husband to pay the wife's Counsel fees.

The Commissioner: I suppose you had many years of experience around the Courts of this State?

The Witness: Well I may say that I was Attorney General of the State of Delaware and tried many cases during that time. I have been a President of the Bar for the past two years and I have been in active litigation for thirty years.

The Commissioner: Yes, all right.

Q. Do you recall in the separation agreement, which was finally executed by Mr. and Mrs. Davis, whether there was a specific provision inserted to take care of Mr. Davis' [fol. 48] obligation for the support of his wife and son?

A. Yes, I am sure there was. I haven't read it prior to coming here, but you have the document before you, I am quite sure.

Mr. Murdoch: This is the exhibit. At this point, your Honor, we have a stipulation here in which it is agreed that the agreement as set forth in the petition is a statement of the pertinent parts of this separation agreement.

The Commissioner: Yes.

Mr. Donahue: Excuse me. As I stated earlier with regard to that stipulation that I would agree that the agreement could be made part of the record, but I felt that the entire agreement would go in as part of the record and not so-called pertinent parts.

Mr. Murdoch: I misunderstood you then. I thought you were going to present as your evidence all of the agreement.

Mr. Donahue: No. I stated that I thought the entire agreement should be made part of the stipulation, that I furnished you a copy of the entire agreement.

Mr. Murdoch: Can we take just a moment on that, your Honor?

The Commissioner: Certainly.

Mr. Murdoch: When I first talked to Mr. Donahue about this I showed him the whole agreement and told him that [fol. 49] we had taken from that agreement the parts we thought were pertinent and had put them in as an exhibit.

The Commissioner: Yes.

Mr. Murdoch: And that I would prefer that the whole agreement not be made part of this record, which would be a public record, which would be available to anyone who would be curious about Mr. Davis' affairs in Wilmington, to go down and look in the public record. I can't imagine what we have left out that has any pertinency here. I assume what Mr. Donahue is going to do is later submit the whole agreement if he thought it was all pertinent and at that time give us a chance to object on that ground.

Mr. Donahue: It is my feeling, your Honor, that the entire agreement is part of the same transaction and should go in, and at that time I told Mr. Murdoch that my first impression was that the pertinent parts, what he considered pertinent parts, would be sufficient. But again, one of the basic questions in this case is whether these expenses stemmed out of personal relationships or out of relationships or expenses that were incurred in the production of income. And we feel that the agreement itself shows that much of the services that were performed stemmed out of entirely personal rlationships. For that reason the entire agreement should go in. And I advised Mr. Murdoch this morning that I would agree to the stipulation providing [fol. 50] that the entire agreement went in.

The Commissioner: I don't see why you would have any difficulty about this as part of a public record in the Court of Claims. I understand that the agreement was made a part of the decree in the State of Nevada, is that right?

Mr. Murdoch: Yes sir.

Mr. Donahue: Yes sir, that is right.

The Commissioner: If one was anxious to read it, they just as well could go to Reno and Washington. I can't see much reason for that. There are not many people that resort to the Court of Claims records anyhow, as a matter of curiosity. It is not like a local Court where people are

liable to drop in, knowing the local prominent people of the area. There is very little of that experience in connection with the Court. And in any event, in the course of time after this case is completed, you may be permitted to withdraw the exhibit permanently.

Mr. Murdoch: Well that I think would take care of my objections, if we could have the right to take out the agreement as a whole after it serves the purpose in this Court. I would have some concern if the entire agreement was to be picked up in a finding of fact which would be published and of course be available throughout the United States.

The Commissioner: It is too long an agreement to set [fol. 51] forth like that. The findings of fact would be too laborious to include so much material. I wouldn't take it that you would necessarily ask that the settlement agreement be set out word for word.

Mr. Donahue: I have no such intention, I can assure your Honor. But I think certain parts of it could be referred to as a due form of basis for certain findings of fact that the Government might wish to be made.

Mr. Murdoch: With that understanding, your Honor, that is agreeable to me.

The Commissioner: All right.

Mr. Murdoch: That was my only concern about it, the publicity.

Mr. Donahue: We will agree that the entire agreement be in as a part of the exhibit to the stipulation.

The Commissioner: You can be sure that discretion will be exercised in a matter of this kind. The Court has no desire to embarrass unnecessarily any person.

Mr. Murdoch: Thank you, your Honor.

Q. Mr. Young, in this agreement in paragraph 5 it is stated that the husband will pay to the wife for her maintenance and support $2,500 on December 15, 1954 and in addition the sum of $550. each month thereafter, until October, 1964; do you find that in your copy of the agreement?

A. Yes, I have an original before me.

[fol. 52] Q. I also call your attention to the fact that in this agreement Mr. Davis created a trust for the benefit of his son, and there is attached to the agreement a proposed irrevocable living trust agreement for that purpose?

A. Uhm hmm.

Q. I would like to ask on the basis of your familiarity with Delaware practice in divorce matters, whether in your opinion those two provisions fully discharged Mr. Davis' obligation for the support of his wife and child in his separation of this type?

A. No question.

Mr. Donahue: I object to that as asking for a conclusion of the witness.

Mr. Murdoch: I am asking for the conclusion of the witness and I believe as an expert he is able to state a conclusion on that.

The Commissioner: There is a difficulty about that, Mr. Murdoch. And that is that I couldn't permit the Chief Justice of the United States to decide the law of a case before the Court, even though he might be considered the foremost expert of the United States. And even though he might be in a position, a strong position from the standpoint of review of the decisions of this Court. I don't think you can call an Attorney to testify as to what the law would be, sir. Isn't that what you are doing here?

[fol. 53] Mr. Murdoch: No, your Honor. I am asking the witness to state whether he believes as a matter of Delaware law, not Internal—the Federal Internal Revenue law—that whether he believes that this arrangement that Mr. Davis made for his wife and son, would under Delaware practice be upheld as a full discharge of Mr. Davis' obligation.

The Commissioner: You see the Court—the United States Court of Claim takes judicial knowledge of the law in the State of Delaware. If you have an Appellate decision of the highest Court of the State of Delaware then you will have no difficulty having the Court recognize the ruling of the State Courts of Delaware in that respect.

Mr. Murdoch: Our problem is, your Honor, to appear that the law of Delaware is like the law of most States, that the husband's duty for support is discharged if he has made a complete disclosure of his assets to his wife, and that a Court is satisfied, taking into account all the circumstances, that this is adequate, including her needs and the husband's assets.

The Commissioner: It is a matter to be represented in the brief anyway. I am not going to make a finding of fact that the law of Delaware is so and so, because the

United States Court of Claims will be open to the respective arguments as to what is the law of Delaware. And you don't have to make any proof whatsoever. You have [fol. 54] got the authoritative decisions of the State of Delaware. You can cite them by volume and page.

Mr. Murdoch: All right, sir.

Mr. Donahue: Your Honor, may we have the witness' answer to that stricken? I don't know whether—

The Commissioner: Yes, it may be stricken.

Q. Mr. Young, in negotiating on behalf of Mr. Davis in this matter, was it understood, at least on your side, that there were two issues here: first, the matter of support payments for Mrs. Davis and their son; and a second matter, a division of property?

A. That is right.

Q. Was that separation of those two items reflected in your drafting of this agreement?

A. I believe an examination or an inspection of the agreement will show that it was.

Mr. Murdoch: Mr. Donahue, are you agreeable to introducing these bills of Mr. Young?

Mr. Donahue: No objection to Mr. Young's bills.

Mr. Murdoch: Mark this for identification.

The Commissioner: Let me ask you off the record—mark this as Plaintiff's Exhibit 1.

(Off the record.)

(Young & Woods bill to Mr. T. C. Davis of November 17, [fol. 55] 1954 was marked Plaintiff's Exhibit No. 1.)

Q. I show you Plaintiff's Exhibit 1 and ask you to state what that is?

A. That is a bill that I submitted on November 17, 1954.

Q. And will you state what this bill recites, the amount is a bill for?

A. Separation agreement and property division between T. C. Davis and Alice M. Davis $7,500. Telephone charges $6, making a total of $7,506. Paid on account $2,500, and the balance of $5,006.

Q. And dc you recall whether Mr. Davis paid the balance of this bill?

A. He did.

Q. Do you recall the date that was paid?

A. Well I don't recall it offhand. I think it was after January.

Q. Do you remember the year?

A. 1955. And that was pursuant to a covering letter that I had, that I submitted with that bill, and another bill, in which I agreed that I would be—it was perfectly satisfactory to me to receive the balance of the fee after the first of the year.

Mr. Murdoch: Your Honor, I would like to withdraw the original of this bill and substitute a photostatic copy of it.

[fol. 56] The Commissioner: Any objection?

Mr. Donahue: No objection.

The Commissioner: That may be done.

The Witness: The balance of that bill was paid on January 28, 1955.

The Commissioner: Any objection to Plaintiff's Exhibit No. 1?

Mr. Donahue: No objection.

The Commissioner: Plaintiff's Exhibit No. 1 is received in evidence.

(Photostat of Young and Woods bill to Mr. T. C. Davis dated November 17, 1954 was received in evidence as Plaintiff's Exhibit No. 1.)

(Young and Woods bill to Mr. T. C. Davis dated November 17, 1954 with balance due of $2,500, was marked Plaintiff's Exhibit No. 2.)

Q. Mr. Young, I show you Plaintiff's Exhibit No. 2; will you state what that is?

A. This is a bill rendered for professional services in the matter of tax matters in the case of Davis versus Davis, at that time in the total sum of $5,000, paid on account November 16, 1954 $2,500, leaving a balance of $2,500.

Q. Was the balance of $2,500, paid by Mr. Davis?

A. Yes, it was on January 28, 1955.

[fol. 57] Mr. Murdoch: I have no further questions of Mr. Young.

(Photostat of Young and Woods bill to Mr. T. C. Davis dated November 17, 1954 with balance due $2,500, was received in evidence as Plaintiff's Exhibit No. 2.)

The Commissioner: Do you have any questions, Mr. Donahue?

Mr. Donahue: Yes I do, sir.

The Commissioner: Very well.

Cross-examination.

By Mr. Donahue:

Q. Mr. Young, when were you first employed by Mr. Davis?

A. I would say around the middle of 1954. It may have been in June and it may have been some time prior to June of 1954.

Q. What specific instructions did you receive, if any, at the time of your first employment?

A. Well I received no instructions. I was consulted for advice. And as I stated previously, Mr. Davis told me that he had—there had been some disagreements between himself and Mrs. Davis and that it looks rather hopeless at the present time, but he still wanted to make an effort at reconciliation and perhaps resolve the difficulties in that way.

Q. Did you make any effort to reconcile the parties?

[fol. 58] A. I did.

Q. What efforts did you make along that line?

A. The effort merely consisted—a visit to Mr. Morford's office in the building across the street, the Delaware Trust Building. I was then at the Equitable Security Trust Building, which is now known as the Bank of Delaware Building. I discussed the matter with him, told him that I represented Mr. Davis; I knew that he was representing Mrs. Davis, and it was Mr. Davis' hope that there could be a reconciliation affected and did he think it was possible? I distinctly recall —well I distinctly recall his saying he didn't think it was possible, but he felt duty bound to convey that information to Mrs. Davis. He did. And subsequently he informed me that it was not possible, and I in turn transmitted that information to Mr. Davis.

Q. Over how long a period did your reconciliation efforts last?

A. In time?

Q. In time?

A. Not over two hours.

Q. Over what period of—I withdraw that. What lapse of time took place between your original efforts to make a reconciliation and your decision that such a reconciliation was not possible?

A. Well I would say—I can't specifically tell you the [fol. 59] time, but I can say that I made a telephone call, I discussed it on the telephone, I then made an appointment with Mr. Morford, came to his office, talked with Mr. Morford, he in turn talked with me again and that was the extent of the negotiations for reconciliation.

Q. After your final talk with Mr. Morford with regard to reconciliation, did you advise Mr. Davis of this fact?

A. No, I advised him only after Mr. Morford informed me that Mrs. Davis would not consider any reconciliation.

Q. What was Mr. Davis' reaction to that?

A. Well he appeared to me to be disappointed and recognized then that we had to go through with a separation agreement. As I recognized it.

Q. Was Mr. and Mrs. Davis at that time—or were they separated?

A. Yes, they were.

Q. Do you know how long they had been separated?

A. It was a matter of either weeks or a few months, not more that that.

Q. Now with reference to Plaintiff's Exhibit 2, which appears to be a bill, with regard to tax matters in the case of Davis versus Davis, specifically what tax matters were concerned in that case of Davis versus Davis?

Mr. Murdoch: If your Honor please, I believe the witness has stated all of this on direct; unless Mr. Donahue has some other witness——

[fol. 60] Mr. Donahue: Your Honor, it is my understanding that he stated that he considered certain tax matters in regard to the separation agreement. The bill says in the case of Davis versus Davis, excuse me. In case of Davis versus Davis, yes.

The Commissioner: Yes, the objection is overruled, you may proceed.

A. Why, as you know, there were very substantial amounts involved in this particular case and we had to consider the tax consequences to Mr. Davis insofar as taxable income was concerned, both with respect to him, and his to her, what capital gains would be involved as a result of the transfer of his stock, which most of—which he received by way of bonuses.

We also had to consider the impact of the tax on the living trust that he set up for the son and whether or not there was any tax consequences with respect to the insurance.

Q. What was the nature of the tax consequences with respect to the insurance?

A. Well there I took the matter up with Mr. Clever Bolton. He is in the Trust Department of the Bank of Delaware now. It was then the Equitable Security Trust Company, and consideration was given to Section 2503 (c) of the Internal Revenue Code of 1954 as it applies to gifts in trust for minors and apparently the Trust Officer in [fol. 61] consultation with me at the time, was of the opinion that our trust agreement was drafted to comply with that provision.

Q. You stated that you were considering the consequences relating to the insurance?

A. I am sorry. That was—I was talking about the—you have asked me about the insurance and I said that—let me go back.

The Commissioner: That is all right, take your time.

The Witness: We did assign the life insurance policy to the trust for a certain period. And I know that we had some discussion about it. Now whether the Section I am talking about, 2503(c), as well as Section 677(b) of the Internal Code had to do with the assignment of the insurance, I am not quite sure. But it had to do with the gift, with the trust for the son. I know we had some correspondence I recall, but I can't——

Q. The majority of the insurance however, went to the wife under the agreement?

A. That is right, yes.

Q. What is your answer that you considered the tax consequences upon the transfer of the insurance to the wife?

A. I know that we considered tax consequences with respect to every item or every item constituting an asset [fol. 62] of which Mr. Davis was divesting himself and transferring to his wife.

Q. With regard to the insurance transferred to the wife, what aspect did you consider there?

A. I don't recall that at this time.

Q. Now you mentioned on your direct examination, you considered the consequences of, the tax consequences of concerning the trust, concerning the transfer of shares and I quote, "other related tax matters;" now what were some of the other related matters?

A. Possible capital gains.

Q. You referred upon that upon the transfer of shares?

A. Offhand I don't recall. I know with Mr. Davis' knowledge about the matter, with the report from Covington and Burling and with conferences with Mr. Morford, everything that we thought might be—might have some impact and some affect on Mr. Davis was considered. And Mr. Davis from time to time kept consulting with us, with me, and in turn having me go over to Mr. Morford, because of the tax implications.

Q. You have mentioned two specific tax implications, one that depended upon the transfer of the shares of the DuPont stock to Mrs. Davis, and two, the setting up of the trust for the son?

A. Uhm hmm.

Q. Are those the only two that you can recall at this [fol. 63] time?

A. Well let me just say—may I?

Q. Yes sir.

A. I think what we considered was whether or not in the separation agreement first, was the wife—what were the benefits of the wife signing a joint tax return pending all this proceeding, that was an income tax return. Then in connection with the share of the DuPont stock, which the wife demanded be transferred to her under the property division, the question arose as to whether or not Mr. Davis

would be exposed to a capital gains tax. Then a further question arose as to whether or not the husband would be exposed to a gift tax liability with respect to any property he transferred to the wife.

Q. Did you consider this a gift?

A. Did I consider this a gift?

Q. Yes?

A. No.

Mr. Murdoch: I object to that. I think that that is a meaningless conclusion if the witness could state it.

The Commissioner: Well what difference would it make whether he considered it a gift or not.

Mr. Donahue: I am just trying to establish, your Honor, that the transfer of the property was an transaction for consideration on both sides, and it could in no way be con- [fol. 64] sidered a gift, and the parties never even thought of it being considered a gift.

Mr. Murdoch: All right, I think we are becoming confused here with terms. We have been talking about whether something is a gift for Federal gift tax purposes, which is not necessarily synonymous as to whether it is a gift in the giver's view, the matter of family relations.

Mr. Donahue: Excuse me. Mr. Young was talking about the gift tax consequences, which is, as I assume, the Federal gift tax consequences.

The Witness: Yes, that is correct. What I am trying to say is whether we came to that conclusion I can't say off hand. The point is we spent some time discussing it and considering it. Whether it was, I don't know at the present time. He also considered—again I come back to the irrevocable trust for the minor son, and there we considered whether the father's contribution was to be allowed as a deduction to the father and whether it would generate again a gift tax liability, whether it would be taxed as income to the mother, that is where Mr. Morford was very much concerned about it and would the trust constitute a taxable entity.

Those matters were taken up as I pointed out previously with the head of the Trust Department, with the Bank of Delaware.

Q. Those however, were the only tax matters that were [fol. 65] taken up?

A. I don't know whether I mentioned we also took up whether the monthly payments by the husband to the wife constitute a tax deduction to the husband and taxable income to the wife.

Q. What are you reading from?

A. I am reading from my notes of the letter that I addressed to Mr. Kenneth W. Gemmill, Esq. of Barnes, Dechert, Price, Myers & Rhoads, dated February 22, 1957.

Q. What was the occasion of your writing that letter?

A. I was requested to submit a letter to Mr. Gemmill stating what matters we had considered in connection with the tax phase of this problem involving Mr. Davis. We pointed out at that time that the 1954 Code became law in August 6, 1954 and all these questions that I just mentioned to you were intensified in importance because of the changes of the 1954 Code over the 1939 Code. And we had no rulings at that time to guide us and we were doing what we thought was the best we could under the circumstances.

Q. In Plaintiff's Exhibit 1 it is stated legal fees were for a separation and property division between T. C. Davis and Alice M. Davis; what property division, if any, took place?

A. In general I can tell you—I have to refer to the agreement (I have drawn literally hundreds, and I don't recall at all) I know there is a transfer of 1,000 shares of stock.

[fol. 66] Q. With regard to the transfer of the 1,000 shares of stock, can you describe that as a division of property?

A. Yes.

Q. Why?

A. I consider it pertinent property as being a division of property.

Q. In whose name was the stock listed?

A. Mr. Davis' name.

Q. It wasn't listed in Mrs. Davis'?

A. I just stated to you it was listed in Mr. Davis' name.

Q. Was any of Mr. Davis' DuPont stock also listed in Mrs. Davis' name to the best of your knowledge?

A. I don't recall any.

Q. What other property was divided?

A. I understand that $30,000. was paid at the time of the agreement in cash.

Q. Did that money come from Mr. Davis?

A. Yes.

Q. Did Mrs. Davis have any title to that money?

A. None.

Q. What other property was divided?

A. The wife received an automobile.

Q. Was that automobile registered in Mr. Davis' name?

A. I can't recall. She also received all of the furniture [fol. 67] and furnishings listed in Exhibit A attached to the agreement.

Q. Who owned those personal effects?

A. I would say presumably Mr. Davis but sometimes there is a great deal of conflict as to who owns furniture. In other words to remove any cloud as to who owns furniture we transferred the furniture to Mrs. Davis. And we listed the items in an exhibit attached thereto.

Q. Mr. Young, did you have any discussion with Mr. Davis with regard to the question of divorce?

A. Yes.

Q. Did you perform any service for him or give him any advice with regard to that question?

A. Well I don't believe I gave him any advice. I told him that this would be consummated by a divorce, which she will obtain as I understood -he was prepared to do by going to Reno, Nevada.

Q. Did you attempt to determine what grounds were present for divorce?

A. Yes. I knew the grounds. And I knew that there were those grounds.

Q. What were those grounds?

A. Well I would say it would be incompatibility or mental cruelty which is sufficient grounds in a State such as Nevada, that recognizes those grounds providing bona fide residence [fol. 68] has been established.

Q. Did you also discuss with him the question of who would be the moving party in the divorce proceeding?

A. I don't know whether it was discussed, but it certainly was implicitly understood that she would be the moving party.

Q. Did you discuss with Mr. Davis at all the question of what jurisdiction the divorce would be obtained in?

A. No, as far as we were concerned, we were not—we didn't care whether she went to Reno, Alabama, Florida, or wherever she wanted to go.

Q. Were your services with regard to the divorce proceeding included in your bill as contained in Plaintiff's Exhibit 1?

A. One being the bill for the separation agreement.

Q. And property division, yes.

A. I would say yes, although it was a rather perfunctory duty I performed by merely engaging Counsel in Reno.

Q. Now you stated that Mr. Morford or that you engaged in various discussions with Mr. Morford, am I clear on this now, did he represent Mrs. Davis in this matter?

A. Yes.

Q. And at that time you and Mr. Morford were not partners and you represented Mr. Davis, while he represented [fol. 69] Mrs. Davis?

A. We were well known as frequent adversaries for close to thirty years.

Q. And you were definitely an adversary in this case?

A. I certainly was.

Q. Now Mr. Young, do you also consider tax consequences when drafting a contract?

A. You are talking about a commercial contract?

Q. Yes?

A. Ordinarily yes.

Q. Do you consider tax consequences when drafting a will?

A. Yes.

Q. When drafting a partnership agreement?

A. Yes.

Q. Articles of incorporation?

A. No.

Q. Do you not consider the franchise taxes or State taxes?

A. No, I know them pretty well. So I don't have to consider them too—are you talking about the organization of the corporation or the articles?

Q. Yes.

A. Or the articles of incorporation. You said articles of incorporation, we think of nothing but the articles of incor- [fol. 70] poration—the stock to be issued——

Q. Let's refer to the organization of the corporation; do you consider tax consequences when drafting a trust?

A. Yes. May I qualify that?

Q. Yes, certainly.

A. As far as trusts are concerned and wills are concerned, the department of the banks have been doing most of that and we refer the matter involved, and they usually consider it and develop it and then submit it to us.

Q. However, you do consider their opinion on it?

A. Yes. No question about that.

Q. Would you say, Mr. Young, that in most of the legal services which you performed for your client, you considered tax consequences of various sorts?

A. In commercial matters, yes.

Q. Even in private matters?

A. Well involving business, trusts, yes. I would say that.

Q. On behalf of Mr. Davis did you negotiate with regard to the support and maintenance for Mrs. Davis?

A. Will you——

Q. Well in your representations on behalf of Mr. Davis, did you negotiate with Mr. Morford with regard to the amount of support and maintenance Mrs. Davis should receive?

A. Yes.

[fol. 71] Q. Did you negotiate with Mr. Morford to permit Mr. Davis to continue in his customary way of living?

A. I don't understand that question. Will you repeat that again?

Q. Let me rephrase it this way: what was your primary purpose in your negotiations with Mr. Morford?

A. Well my——

Q. —or objective?

A. —Well the objective as I stated at the outset was to be fair in the first place, but to minimize as much as I could the obligation on the part of Mr. Davis.

Q. In order to permit Mr. Davis to maintain his usual manner of living?

A. I believe so, yes.

Q. Did you negotiate in any way to prevent the loss or sale of his personal property or home?

A. I don't know what you mean—the loss—or sale—I don't know what you mean by that.

Q. Did you attempt, was there ever any danger of Mr. Davis losing his home or being forced to sell his home as a result of these separation negotiations?

A. I don't recall that. I want to say this: that Mr. Davis, as far as I was concerned and as it ultimately proved in the consummation and formalization of this agreement, was so fair about the situation that we had very little difficulty [fol. 72] in our negotiations with respect to a property division and maintenance and support. In other words the area of discussion was such that there was no question that we could come to some agreement between Counsel with respect to husband and wife.

Q. And is it true to say that much of your negotiations centered around the personal rights of the parties?

A. I would say so and I do want to say this, without acting the party of the advocate in this particular proceeding, if you will accept it that way, that here was a total charge of $15,000, two-thirds of it was charged for the services in connection with the negotiations and the separation agreement, and the other part was charged, the one-third for the other time that was consumed day in and day out, hour in and hour out, in connection with the tax consequences.

Q. Did you mean $7,500, sir?

A. Yes.

Q. I believe you said $1,500.

A. No, the total from the previous year. The entire figure was $15,000.

Q. Did you spend substantial time concerning—with regard to the trust which was set up for Mr. Davis' son?

A. No.

Q. There was no disagreement as to that trust?

A. No. There was no disagreement. It was just a ques- [fol. 73] tion of having it worded properly, phrased properly, and the Trust Department drew the papers subject to my approval and that of Mr. Morford.

Q. Is that the Trust Department at the Bank you were referring to?

A. That is one of the reasons for some pending litigation between the Delaware Bar Association and the Bank as to who was to do that work. And what constitutes practice of law.

Q. What negotiations, if any, took place with regard to

the ownership of personal belongings such as silver, linen, etcetera, furniture?

A. Mr. Davis, if I may characterize him now, was very magnanimous about that. He said she could have whatever she wanted. She could go to the house and pick out what she wanted.

Q. As Mr. Davis' Attorney could you state whether at the time of the separation agreement Mr. Davis intended to obtain a divorce?

A. At the time of the separation agreement?

Q. Yes?

A. Yes.

Q. Mr. Young, what consideration, if any, did you give to the question of the effect a decree of divorce might have upon the separation agreement?

[fol. 74] A. That the separation—well under the law as I understand it, and in my experience, if you enter into a separation agreement the divorce will not affect it or destroy it, notwithstanding the decree. And in fact in Delaware notwithstanding the fact that it is not incorporated in the decree.

Q. Did you give any consideration to the question of whether the Court in divorce decree might have awarded all money in addition to the contractual obligation?

A. I didn't consider it because again drawing on my experience, if I may, I have never known where a Court will disregard an agreement entered into between the respectiv parties and enter a separate or different sort of an order, suo sponte—of its own volition.

Q. What agreement, if any were there between the parties to have the separation agreement incorporated in the divorce decree?

A. It was definitely understood that this separation would be made part of the decree.

Q. I believe it was your testimony, sir, that at first Mrs., the former Mrs. Davis, demanded one-half of Mr. Davis' DuPont stock holdings, is that correct, sir?

A. Yes.

Q. If you recall, what was your initial offer with regard to the stock holdings?

[fol. 75] A. I don't recall. But I think it was somewhat less than the amount we agreed upon, but I don't think too far below that.

Q. In other words slightly less than 1,000 shares?

A. It might be, yes. I might add one other point. I may clarify it for you, when you say what assurance or practically the implication of your question was what assurance did we have that this agreement would be incorporated in the decree, that stock would not have been delivered unless this agreement was incorporated in the decree.

Q. Now Mr. Young, I believe you also testified that it was a practice here in Delaware for the husband to pay Counsel fees in divorce proceedings, is that correct?

A. Oh yes.

Q. What was the occasion of Mr.—strike that. What was the specific reason for Mr. Davis to pay his wife's fees in this case?

A. Had he refused, Mr. Morford could have refused to accept the terms of the agreement, instituted proceedings, and have the Court allow him Counsel fees, as I have done on many occasions.

Q. In this case did the Court or did any Court impose an obligation upon Mr. Davis to pay Counsel fees?

A. No. No. Because we had entered into an amicable separation agreement. Had we failed in that, Mr. Morford [fol. 76] would have the right to go into Court, demand maintenance and support and property division and request for Counsel fees.

Q. That is your opinion, sir, is that right?

A. It is not only my opinion, it is a fact.

Q. Based upon your practice in Delaware law?

A. And the practice of other Attorneys that have handled similar cases in the State of Delaware.

Q. You know of no customs to the contrary?

A. Well I don't know what you mean by "customs to the contrary." You mean of a disallowance?

Q. I will rephrase. You know of no occasion when such fees have been disallowed?

A. That is a different point there. There might be—well I don't recall of any—it might have been disallowed where you got a husband almost in destitute circumstances. In any case, even where the husband earns a salary of $50. to $75. a week there has been allowances. And of course the amount allowed would be commensurate with the earnings and the assets of the husband. I can give you an example of just within the past two or three weeks.

Q. I don't think I care to go into it any further, thank you.

A. If you want something on the allowances.

Q. Mr. Young, would you say or can you state whether at the time of the separation agreement Mr. Davis' purpose [fol. 77] in employing you was to get rid of his wife with—at the least cost to him?

A. His purpose when he first engaged me?

Q. No, at the time of the separation agreement?

A. At the time of the—will you repeat that question?

Q. Would you say at the time of the separation agreement was entered into, that Mr. Davis's primary objective was to get rid of his wife at the least cost?

A. I wouldn't say that was his primary purpose.

Q. What would you say, sir?

A. I would say Mr. Davis was a very unhappy man, both prior to the execution of the agreement and at the time of the execution of the agreement and that he was very much concerned not only about the separation and the ultimate divorce, but also about the fact that he was being divested of a substantial holding of his stock and also of his property.

Q. You say that he was a very unhappy man; did he discuss these personal problems with you?

A. Yes he did.

Q. He had numerous personal problems, did he not?

A. Well the personal problems arose out of this separation, surely.

Q. As a matter of fact, all of his problems, personal and otherwise, arose out of the separation?

[fol. 78] A. That is true. His concern for the tax consequences, his concern about the separation, his concern about the payments that he had to make and about his divesting himself of his holdings, they were all of primary concern to him.

Q. One last question. Mr. Young, to the best of your recollection, what if anything did Mr. Davis tell you with regard to a possible intent to remarry subsequent to his divorce?

Mr. Murdoch: I object to that. I think that is entirely beside the point in this case, and just as a matter of satisfying curiosity as far as I know.

Mr. Donahue: Your Honor, I can assure you that it isn't

a matter of satisfying personal curiosity. The Government in this case obviously contends that the expenses arose out of purely—for purely personal reasons, whereas the Plaintiff obviously contends that these expenses were connected with an income producing motive. And I am just trying to ascertain whether in this respect the person's motive may have been behind the separation agreement.

The Commissioner: The objection is overruled.

A. Will you repeat that question?

Q. What, if anything, did Mr. Davis tell you with regard to a possible intent to remarry after his divorce?

A. Remarry Mrs. Davis?

Q. Well to remarry, period?

[fol. 79] A. I never heard of any remarrying of any—to anyone.

Q. Fine. Thank you, sir.

A. As a matter of fact, it came to me as a surprise when I later at some time (and I don't know when) that I learned that he had remarried.

Mr. Donahue: That is all I have, your Honor.

Mr. Murdoch: Just a few questions.

Redirect examination.

By Mr. Murdoch:

Q. In your cross examination, Mr. Donahue mentioned the fact, and I think you confirmed it, that the DuPont stock was registered in Mr. Davis' name alone; is it not a fact that in Delaware a wife, even though she does not have title to certain property, has rights in her husband's property or in-co-ent?

A. That is right.

Mr. Donahue: Objection. Again we are asking for a question of Delaware law.

Mr. Murdoch: On that I want to press that. This is merely following up something that Mr. Donahue opened up as to where the title is.

The Commissioner: I will take it for classification purpose but not to establish the law.

The Witness: My answer is yes.

Q. In this matter of various t... matters you considered, is it not, sir, so that Delaware has a tax income tax law [fol. 80] very much like the Federal tax law, generally speaking.

Mr. Donahue: Objection again, your Honor. I think that this is going into legal matters and not factual, and certainly the Court, as your Honor has pointed out, can take judicial notice of this.

The Commissioner: That is right.

Mr. Murdoch: I will withdraw that.

Q. And ask you whether the concern you had over Federal tax matters would also have a bearing on Mr. Davis' Delaware tax liability?

A. Yes.

Mr. Murdoch: I have no further questions.

The Commissioner: Any other questions?

Mr. Donahue: Just one question please, sir.

Recross-examination.

By Mr. Donahue:

Q. Mr. Young, did Mrs. Alice Davis give up any rights to dower, inheritance and the like at the time of the separation agreement?

A. Yes. Oh yes.

Q. And that is contained in the agreement, is that right?

A. May I have a moment? I am quite sure because that is one.

Q. Yes.

[fol. 81] A. Paragraph 7 provision that "the wife accepts the division of property as herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise."

Q. I think that would be sufficient?

A. Yes, it is part of it.

Mr. Donahue: That is all I have.

The Commissioner: Any other questions? Can Mr. Young be excused from further attendance at the Court room?

Mr. Donahue: It is quite agreeable to me.

Mur. Murdoch: That is all right.

The Commissioner: We will stand recessed for five minutes at this time.

(Short recess.)

The Commissioner: Let's go ahead.

Mr. Murdoch: Your Honor, I would like at this time to submit the stipulation of facts.

The Commissioner: All right, very well. I think that you have been supplied a copy of this?

Mr. Donahue: Yes sir, I have. It is my understanding that we should have connected with that stipulation, the [fol. 82] agreement as an exhibit to the stipulation. Isn't that what we discussed before? I don't believe we——

Mr. Murdoch: We can do it either way. Either agree that it be made an exhibit or agree that it is in the record to get it in the record.

Mr. Donahue: Couldn't we just have it marked for an exhibit?

The Commissioner: Very well.

Mr. Donahue: Let's mark it as Exhibit B to the stipulation.

Would you make this Exhibit B to the stipulation of facts?

(The agreement between T. Crawley Davis and Alice M. Davis dated the 4th of November, 1954 was received in evidence as Exhibit B to the Stipulation of Facts.)

T. Crawley Davis, having been sworn, was examined and testified as follows:

Direct-examination.

By Mr. Murdoch:

Q. Mr. Davis, will you state for the record your address and occupation?

A. Room 9016 DuPont Building; Vice-President, Member of the Board, Member of the Finance Committee, Member of the Executive Committee of DuPont, Du Pont Company.

Q. You are one of the two petitioners in this Court of [fol. 83] Plaintiff's proceedings, is that correct?

A. Yes.

Q. The stipulation that has been filed here recites that in 1941 you were married to Alice M. Davis; will you describe for us the situation which arose late in 1953 between you and Alice M. Davis?

A. Well, Mr. Murdoch, you say late in 1953. I think we better——

Q. Going back——

A. Near 1953.

Q. When your difficulties started?

A. Well in mid-1953 Mrs. Davis seemed to have a change of viewpoint toward our relationship and that was first evident by a request for me to—in casual terms—not-be filled out for a division of property to the end that one half of my property would be in her name. She was more specifically at that time concerned with the shares of DuPont stock.

Q. Let me interrupt you there. At that time that demand was made by Mrs. Davis was anything said by her about a separation or a divorce?

A. No. As a matter of fact, Mrs. Davis said, "I would like to have the economic position that you can give me: I would like to have the social position that you can give me, but I insist on having one half of the DuPont stock." At that point she was specific as to the stock, being in my name. [fol. 84] I said, "I just cannot do that. I am an Officer of the Company; all the stock that I have received has been by way of bonus; we are expected to save our bonus stocks.

I would not be understood in transferring half of it to you. Moreover if I transferred half of it to you, I would have no—I would thereby lose that base for taking care of us in adversity and upon retirement. I would have no control over it. I cannot do that." The situation——

Q. Let me interrupt you again, Mr. Davis. Did Mrs. Davis consult an Attorney to your knowledge?

A. She consulted an Attorney, but the exact time I cannot say. She first engaged a Mr. Hitchens in Wilmington, Delaware who told her—well he told me later on after he had withdrawn from the case, that he felt he could not represent her any longer.

These requests of Mrs. Davis were presented not daily, but let's say weekly, and her attitude toward me became cold. I might say even hostile. And by Christmas time that year why our relations had become strained indeed.

Now in the meantime, I had attempted to persuade her that we had had a few years of happy life together and we could have some more years of happy life, and that my inability to meet her request was not—should not be construed as not properly taking care of her. Because I had made a proper will: she had seen it and she had approved it, and except for a reasonable percentage going to my son [fol. 85] by another marriage, she had control of the whole property and she knew that.

She said that that was not satisfactory to her. Now because of this, our continual friction and bickering, in September of 1953, I made a donation to Mrs. Davis, a gift to Mrs. Davis of 200 shares of DuPont stock. When I did that I had this kind of a conversation with her. "Now I can't meet your requirements or your request because it has a serious potential adverse effect on my position in the company. Now I am making you this gift of 200 shares of DuPont stock and in connection with this I will make this statement: that in the future I will be willing to make further gifts to you of stock to the end that shareholdings in my name do not move below 3,000 shares. She seemed to be considerably satisfied by that. But nonetheless that was, shall I say, either a momentary reaction or superficial. It did not hold, and by Christmas of that year our relations had become so strained that it was rather unhappy to be around the house.

Q. Let me interrupt there and ask you when you made the gift of 200 shares and when you made the statements to Mrs. Davis about your willingess to make future gifts; were you in any way indicating to her that you would do this in consideration of a legal separation or a divorce?

A. Oh no.

Q. Was that even mentioned at that time?

[fol. 86] A. No. No.

Q. Still no mention of divorce or separation?

A. That is right.

Q. Go ahead?

Mr. Donahue: Excuse me. What is the question?

Mr. Murdoch: I asked whether at the time the 200 shares of DuPont stock were given in the fall of 1953, and at the time Mr. Davis stated he would be willing to make future gifts, did Mr. Davis state that was in consideration of divorce and/or separation, and I understood the answer was no, it had not been mentioned yet.

Mr. Donahue: Well——

The Witness: Now what——

The Commissioner: What is the question you want?

Mr. Murdoch: I was asking Mr. Davis to state whether that was so that there was no——

Mr. Donahue: I want to know what the new question is, the next question is. You just nodded to Mr. Davis.

Mr. Murdoch: I am sorry, I misunderstood. I was suggesting to Mr. Davis to go ahead and recite what happened between Mr. Davis and Mrs. Davis.

The Witness: Well some time after Christmas of 1953 after the early part of 1954—the exact time—I probably [fol. 87] could find but I don't recall it—Mrs. Davis' demands became more insistent and when I brought to her the tax returns to be signed, I think this was in February of 1954 (they are due in March) but I had them a little early, she said to me that, "I will sign no further tax returns until you have met my demands." And of course that well—it was quite a shock. And it showed her determination ~~to be~~ unhappy, shall I say, was pretty well grown. I hadn't realized it up to that point. I thought it was superficial. So I said to her that, "I just cannot see you

acting in that capacity. I just don't see that that gains anything for you or gains anything for me." And in a short while she came to me and said that, "I have engaged Mr. Morford." "I want you to engage an Attorney and I want a separation agreement to be worked out." And I said—I declined. "I have no interest in contributing to breaking up the family; I see no reason for it, no necessity for it, and therefore I am not going to be a willing participant in it."

And we grew further and further apart and she almost—it was almost impossible for us to carry on a conversation. As a matter of fact I might put it this way: although it seemed awfully harsh, it seemed to me that Mrs. Davis had embarked on a program or a course of action which she thought would drive me from the home, and therefore would give her the position of being a deserted wife.

[fol. 88] Well I had no intention of leaving the home although it was an unhappy one, I had no intention of leaving my home. I also had no intention of engaging an Attorney. I had no intention of discussion a separation agreement or division of property. And it only became clear to me about September, 1954 that I had lost the battle. That I couldn't win a reconciliation. I couldn't bring the family back to a reasonable relation with each other and that her request for a separation agreement would—probably represented the only thing that was left for me. At that time I engaged Mr. Young. You heard Mr. Young this morning.

Now Mr. Young made a statement this morning that is not entirely correct. He said that at the time I came to him that we had practically worked out the agreement. My memory is better than his; as a matter of fact my notes are better than his; when I went to Mr. Young I was determined to do everything possible to see that there was no such agreement and I have made no mental, written, oral division of property, payments of sums or anything of the kind. The effort of Counsel failed as my efforts had failed and, well, at that point I had been confronted only with this general oral request, "I want one half of the property in my name."

Now at that point when I told Mrs. Davis under the cir-

cumstances I had engaged Mr. Young, the next situation that confronted me was a specific demand, that is, a demand [fol. 89] of—with specifications.

Q. Who made this demand?

A. It came through Mr. Morford to Mr. Young to me. And that demand was, the first one was "1,500 shares of DuPont stock in my name immediately," 3 one thousand dollar—3 fifty thousand dollar insurance policies, premiums paid up, loans there against to stand and interest to be paid by me, one half of the value of the house, one half of all the household goods, an Oldsmobile automobile—and may I refer to my notes here because I forget the exact amount. Is that satisfactory to you?

The Commissioner: Certainly, take your time.

The Witness: $1,000 per month for life. Now those were the original demands. I told Mr. Young that they were absolutely impossible; I couldn't comply with them. One of the reasons I couldn't comply with them was that I could not stand the jeopardy to my position with the company by an out of hand transfer of 1,500 shares of stock at that time.

A little bit later without any further word from me, a little bit later—I am sorry. Would you change the $1,000 to $400?

A little bit later without any further effort on my part or action on my part, just waiting, a plan came through Mr. Morford to Mr. Young to me. And the plan was 1,500 [fol. 90] shares of DuPont common stock to be delivered free and clear upon my retirement from DuPont Company and $1,000 per month for life, and 3 insurance policies, and everything else. I told Mr. Young that that was equally unacceptable, that I could not do it. The 1,500 shares transfer upon retirement had apparently been devised to meet my requirements that I could not divest myself of stock while a Director and Officer of the Company.

On the other hand it would have—it would have added financial burdens that I didn't see how I could carry.

Now I then offered a plan that I thought was adequate Am I detailing this too much?

Q. No, you go ahead. That is fine.

A. I offered payments of $18,000 per annum for ten years, a separate irrevocable trust for Steve, that is my

child, about $2,800 for ten years, pay off the loan, and pay up the premiums on one $50,000 insurance policy and deliver it to her, $24,000 as a fixed payment on the—with respect to the house, one half of the house and the contents. It had a mortgage on it, therefore and of course the Oldsmobile car.

Well this was rejected out of hand. No opportunity to discuss it at all. It was rejected out of hand.

Then a third plan was presented through Morford through Young to me. And this plan was, annual payments for life amounting to the dividends on 3,000 shares of [fol. 91] DuPont stock. That was my total holdings at that time. A separate trust and a $100,000 insurance policy rather than the $50,000 she had requested for the 150; I had overruled 150; she had asked for 100. One half the value of the contents in the house and the Oldsmobile car remain the same. I told Mr. Young that was no improvement on the other, that I just could not undertake such—I could not sign myself to such an undertaking. I didn't see how I could carry it out.

Then I made a second plan and the second plan was similar to the first, $18,000 per annum for ten years, separate trust for Steve ten years, $50,000 insurance policy paid up, no loans against it, and $30,000 as a fixed fee—a fixed payment in respect to the home and the contents.

Q. You say—when you stated this plan you stated that to Mr. Young?

A. Yes.

Q. With the idea that he would recite that back?

A. Oh yes, yes. This was not acceptable. And was rejected through the channels, Mr. Morford, Mr. Young to me. Then I told Mr. Young that I saw no way in the world to deal with this but all four of us to sit down (we were working in four different places at different times) and he arranged a conference at which Morford, the ex-Mrs. Davis, Mr. Young and myself were present. And at that conference we worked out what is contained in the settlement, [fol. 92] property settlement and separation agreement.

Now I don't know whether I am overextending myself or not, but at the outset and continuing even up to the time where I had engaged Mr. Young, there was no thought of a divorce. Mr. Young seemed to think otherwise. The mat-

ter of a divorce entered late, and it entered because of two very—two factors that were pressing on me. One, the very unreasonable treatment that I thought I had received, obviously I think I am the injured person, and the other—(received at the hands of Mrs. Davis) and the other was evidence that Mrs. Davis was intending to obtain her separation agreement and then retain my name.

Now I will give evidence of that. I don't know what time Mrs. Davis did it, but it was some time during the forepart of 1954 she went into town and bought a separate home. I didn't know that. That was probably one of the reasons why she was she was unable to contemplate any reconciliation or rebuilding of the family relationship. She had set her eyes and mind on this separate home of her own. And when she had the telephone listed she had it listed Mrs. T. Crawley Davis. And other things had occurred. So I went to see Mr. Young about this and I said, "I think that this situation is pressing in on me in such a way that in order to protect my name and in order not to have it bend around in a way that would be embarrassing from time to time and [fol. 93] matters that I can't now foresee, I think that some consideration should be given to finding a break of this by way of divorce." Now my recollection is that that was some time in November.

Q. Of 1954 that is?

A. Yes. Just about the same. Now I was quite ill about that time. I spent some time in the hospital and during the time that I was in the hospital this view of mine that perhaps the separation agreement was not going to be a happy situation for me, and that it should be followed at some time by a divorce, Mrs. Davis paid me a call at the hospital--the only call she paid me in the hospital—and she requested, she asked me why I had entered this divorce thought. And I told her and she said, "I have not intended a divorce." I said, "I know, we haven't talked about one but I feel that that is almost mandatory on me now. I don't feel that there is any opportunity for me to come out of this situation alive unless we make a complete break and separation."

And from that point on why the discussions about divorce were carried on between Young and Morford and Morford and Mrs. Davis, and characteristic of her, when it was de-

cided to be done, she decided to do it quickly. Now I think I am about at the end of——

Q. Yes, I would like to go back in time. Just a little bit here. In the stipulation that we filed there was a recital [fol. 94] of your various positions with DuPont Company, starting in November of 1934, when you were the Manager of the Tax Division of the Treasurer's Department, and carrying out—carrying up to the present time, and this recital indicates that from January of 1948 to December of 1953 you were the Treasurer of the Company. You have testified here that it was during the last part—latter half say—of 1953 that Mrs. Davis began to make demands upon you for delivery of half of your DuPont stock to her; could you tell us whether at any time during that period you were being considered for additional positions with the DuPont Company?

A. Yes, I was being considered for Board Membership, for Vice-President, and for Member of the Executive Committee.

Q. Did responsible Officers of the Company tell you this?

A. The Chairman of the Board and the President.

Q. And this was all known to you at the same time that Mrs. Davis was making her demands for stock?

A. Well we have to get it anchored I think in point of time. It was known I think after the first of November, 1953 let us say.

Q. And did Mrs. Davis at that time know any of what you have just stated about your post, promotions within the Company, additional responsibility?

A. I don't think that she did.

[fol. 95] Q. Let me say it this way: did you tell her about it?

A. No. Oh no. I don't see how she could have known because I did not tell her.

Q. You have been with the DuPont Company for 25 years now, nearly 25 years, at that time it was 20 years, did you during that tenure with the Company gain any knowledge about the Company's overall policy regarding stockholding by Executives of the Company?

Mr. Donahue: I object to that. It is not shown or the evidence or the records shows no evidence that there was

such an overall policy. You are assuming a fact not in evidence is the specific ground of my objection.

Mr. Murdoch: I think probably this objection is going to be important for a lot of things we are going to talk about here. I would like to address myself to that for a minute. We are not here to prove that the Company had a particular policy, although I think it can be proved. But that is not our burden. Our burden is to show that Mr. Davis honestly and with reasonable basis believed that the Company had a policy and that in attempting to comply with that policy he was protecting his position with the company; now there is no doubt, I believe, what the Company's was as Mr. Davis is prepared to testify it was. But whether it was or was not is not the question. The question is, did Mr. Davis honestly believe it was and therefore act on that belief.

[fol. 96] The Commissioner: Of course with his record of employment by this Company he is certainly in a position to know what the policy was. Why don't you hit right at it and ask him what the policy was?

Q. What was the DuPont Company's policy regarding stock ownership, ownership of the DuPont stock by Executives of the Company?

Mr. Donahue: I am going to object to that for the record, if it please the Court.

The Commissioner: Yes.

Mr. Donahue: That he is asking for a conclusion of the witness and an opinion of the witness.

The Commissioner: The objection is overruled.

Mr. Murdoch: You may answer.

A. Could I state the policy and then?——

Q. I am coming to it.

A. —And buttress it a little bit.

Q. Just state what you understood the Company's policy was?

A. The Company has a bonus plan; it has been in existence since 1902 I think; the primary objective of that bonus plan is to reward superior performance and particularly in those who show potential for top management. Now prior to 1943 these rewards were made all in stock. The objective as stated in the plan itself was to take—

[fol. 97] these are my words as distinguished from the

exact language—to tie these bonus awardees to the Company in the position of a shareholder, and thus integrate ~~their~~ interest in the Company as a shareholder.

In 1943 there had to be a shift for the years 1943 and through 1946 it was all cash. The shift came about by the emergence of the Federal Withholding Tax and the heavy impact of the tax during the war. And back in 1947 we shifted to part cash and part stock, trying to serve both masters, one is the making of shareholders out of bonus awardees, and the other is the tax problem.

Now it is, it has long been—it is not written—except by those who have been willing to express it, and it is written in that form—it has long been the policy expectation of top management of the Company that these bonus awardees would save their stock. The only two exceptions that have ever been countenanced openly was recognition of the necessity to sell stock to pay tax of some kind, and the other was to buy a suitable home.

Therefore, the policy of this Company through its bonus plan is to make shareholders out of the bonus awardees and to expect those shareholders to hold that stock.

Q. And when were you first made aware of that policy?

A. Well I came with the Company in mid-1934, and from the very beginning I had close association with Mr. Emilie [fol. 98] DuPont, Lamont DuPont Copeland, Pierre DuPont, Walter Carpenter and since that time I have participated in every important discussion, policy discussion and decision concerning the bonus plan and its operation. It is just a part of me, as a result of that long indoctrination.

Now moreover I think maybe I might add a little something to that. When I came with the Company my department head, the Treasurer, was James B. Eliason. And Mr. Eiason used to—well he used to present to me on an average of once a week this thesis that bonus stock is to be saved, not squandered. And through the operation of making shareholder interest and employee interest, the potential, the future management of the Company can be assured to be on a higher level than would otherwise be the case. Because it comes from people who have both interests.

Now Mr. Eliason used to—well he somewhat boasted that

he never sold a share of bonus stock in his life and on occasion he would show you a listing of all his share certificates, all his bonus awards to prove that point.

That, coming from my department head, was of course, not a casual thing at all, but rather a daily way of life, let's put it. Now Mr. Eliason was elected to the Board from the office of Treasurer holding 28,000 plus shares of stock.

Q. And did you understand because of his attitude when you were initially with the Company that that was the [fol. 99] reflection of the attitude of the other officers of the Company?

A. Oh, there couldn't be any doubt about it.

Q. Between that time and 1953 was there anything to change your opinion about the Company policy?

A. Strengthen it. With the recognition that the income tax fight was getting so that it was often times hard.

Mr. Murdoch: I would like to have this marked for identification.

(The book, "The Uncommon Man," by Crawford H. Greenewalt was marked as Plaintiff's Exhibit No. 3 for identification.)

Q. Mr. Davis, I hand you Plaintiff's Exhibit No. 3, which is a book entitled, "The Uncommon Man," and the author is Crawford Greenewalt and it was published by McGraw-Hill Book Company in 1959 and I ask if you are familiar with this book?

A. Yes I am.

Q. You have read the book?

A. Yes.

Q. Is the author of this book the President of DuPont Company.

A. Yes.

Q. Was Mr. Greenewalt the President of the Company in 1953?

[fol. 100] A. Yes.

The Commissioner: And ever since that time?

The Witness: Yes.

* * * * * * *

[fol. 101] Q. Mr. Davis, at the time that Alice M. Davis was making demands upon you for delivery to her of one half of your DuPont Company stock, you testified that you were under consideration for election as a Director and Vice-President and as a Member of the Executive Committee of the DuPont Company; did you believe that compliance with Mrs. Davis' demands regarding your DuPont stock would jeopardize those promotions or promotion in the Company?

A. Yes. If these demands had been met at the first moment of their appearance it would have been necessary—the proper thing for me to do as an Officer of the Company or a potential Board Member—was to go to the Chairman [fol. 102] of the Board and the President and tell them that I had been divested of one half my share holdings. They would have been sympathetic to my plight, but I am quite sure that they would have had the same reaction that I have, and that is, that to show on a proxy statement immediately after election, the disposition of half of the share holdings is not a proper position for a Director, especially, or a poor one and replace him.

Q. And were you at that time dependent upon your salary from the DuPont Company and your dividends from the DuPont Company for your livelihood?

A. Entirely.

Q. Has there been any Company arrangement about revealing these divestitures of stock holdings which has confirmed your belief that this is taken as a very serious matter?

A. Once each year the Executive receives from the Secretary who is in charge of the stock record an analysis of the bonus shares that have been received; this analysis started in 1947—I have to make that clear—we didn't go back of that again, and the dispositions and the retentions. Now on that analysis the President and the Vice-President are sent out as a separate group and we are expected, if any one of us have had, any substantial significant dispositions of stock, we are expected to speak up and say why. Moreover, just prior to Board Meeting any Director who has [fol. 103] made substantial disposition of stock is reminded by the Chairman that he should look forward to questions

from shareholders from the floor at the shareholders meeting and should be prepared to meet those questions.

Is that responsive to your question?

Q. Yes it is. When you discussed with your lawyer, Mr. Young, the matter of these demands and counterdemands did you make known to Mr. Young what you have stated here today about your fears with respect to your position with the Company if you were divested of the stock?

A. I did.

Q. And did you instruct him to resist those demands with that in mind?

A. I did.

Q. And the agreement as finally executed prior for only 1,000 shares as opposed to 1,500 shares being delivered to Mrs. Davis, the agreement also provided that the delivery would be staggered, 500 shares one year and 500 the next; can you tell us why that was important to you that it be done that way?

A. Well the first delivery was to be made in April, 1955, that was after the 1954 proxy statement was out. By that means I would not show on the 1954 proxy statement as having diluted stock in the year of election. And [fol. 104] particularly to the Finance Committee I was elected that year. And then the other 500 shares would be delivered in 1956, after the 1955 proxy statement. Now by that device I was able to dilute this down trend in my shareholdings to keep it from being such a shock, pointed matter.

Q. And to your knowledge were a large part of the negotiations between the lawyers directed to that very point?

A. Mr. Murdoch, I wouldn't be able to answer that. You mean, let me see if I understand you correctly. You mean to the point of my desire for staggered delivery?

Q. Staggered delivery and to resist the demands for the 1,500 shares?

A. To resisting the demands absolutely. I told Mr. Young that I wouldn't deliver any under any circumstances, the situation got too warm and I couldn't live with that. As to the staggered delivery, it came out of this conference that I referred to, this four party conference at which we carved spelled out, what do you have before you, the separa-

tion and property settlement agreement, and I at that point put forward that I can make this delivery only in this way.

Q. I just have one more question, Mr. Davis, and that relates again to the separation agreement. In your discussion with Mr. Young and this conference with Mrs. Davis and Mr. Morford, did you at any time have in mind or state that you were delivering these DuPont shares [fol. 105] as a discharge of your alimony obligation?

A. Oh no.

Mr. Donahue: Objection. I think, your Honor, that this pertains to matters which are set out in the contract and or in the separation agreement. That agreement of course speaks for itself. And I don't think that Mr. Davis—his conclusions with regard to that agreement are relevant. As a matter of fact he is just giving an opinion as to that which is already in evidence.

Mr. Murdoch. Your Honor, first of all this isn't the situation where the agreement speaks for itself in this action which I always thought was synonymous of the proper rules that the rules are only applicable where the parties to the contract are disputing. Here is a dispute between Mr. Davis and the United States. The United States obviously is not a party to this agreement. I believe it is pertinent to ask Mr. Davis what was the background of this agreement. The purpose of showing what the real intent of the agreement was.

Mr. Donahue: The Government has no objection to the question as to the background. The question as to what this particular paragraph in essence that is what it is, what does this particular paragraph of the agreement means is improper. Mr. Davis isn't the lawyer.

The Commissioner: All right, very well.

[fol. 106] Mr. Murdoch: I will withdraw the question and state it this way:—

Q. In negotiating about this agreement, not in executing, but in negotiating about it, did you ever intend that you would discharge your support and alimony obligation by this delivery of the stock?

A. No.

Mr. Murdoch: That is all I have.

Cross-examination.

By Mr. Donahue:

Q. Did you consider the delivery of the stock to be a gift to Mrs. Davis?

A. No. I considered it an exaction from me.

Q. And what do you mean by "an exaction"?

A. What do you mean by a "gift"?

Q. Did you receive any—did you receive anything in return for these——

A. No.

Q. —stocks?

A. No.

Q. Did she give up her rights to the remainder of your property?

A. Mr. Young read you the provisions in the agreement this morning which I believe is normal under such circumstances.

Mr. Murdoch: I think we are back now to Mr. Donahue's very objection which I think is very well taken. What [fol. 107] is the legal effect of this?

The Commissioner: What you are after is in the agreement itself.

Q. Let me put it like this: isn't it true, Mr. Davis, that in return for her separation you agreed to do certain things, one of which was the transfer of the stock?

A. No.

Q. How would you——

A. I have answered your question.

Q. I don't think you have, sir.

A. What I did was under duress, under pressure. The only way to continue to live.

Q. Did you not do it in return for her obtaining a divorce and agreeing to relinquish——

A. No.

Q. —her rights to your property?

A. The relinquishment has already been dealt with. I think that is not unusual at all.

The Commissioner: I think after all, you oughtn't to argue with this witness about the legal effect of this document, Mr. Donahue. I don't think we could change it.

Mr. Donahue: That is quite true, I am afraid, your Honor.

Q. Mr. Davis, what were your positions with the DuPont Company in November of 1954?

[fol. 108] A. It is in the stipulation.

The Commissioner: Do you want to address yourself to the matter contained in paragraph 12 of the stipulation?

Mr. Donahue: No, I restricted it to year 1954, your Honor.

The Commissioner: I see, all right.

A. Well in November 1954 I was a Member of the Board, a Member of the Executive Committee, Vice-President and was elected to the Finance Committee.

Mr. Donahue: Would you make this Defendant's Exhibit No. 1?

(Booklet entitled "By-Laws of E. I. du Pont de Nemours and Company July 20, 1953," was marked Defendant's Exhibit No. 1.)

Q. Were you also Treasurer of the Company in 1954?

A. No. I relinquished the Treasurership when I was elected to the Board and the Executive Committee and made Vice-President.

Q. Now I show you, Mr. Davis, what has been marked for identification as Defendant's Exhibit No. 1 and ask you whether you can identify that?

A. Well it certainly has a familiar appearance. In what way do you want me to identify it?

Q. What is it?

[fol. 109] A. It is the by-laws of the DuPont Company.

The Commissioner: What you want to know is if it is a true and correct copy of the by-laws of the E. I. du Pont de Nemours and Company as of the present time or as of?

Mr. Donahue: As of the year July 20, 1953 through July 18, 1955.

Mr. Murdoch: That is the one with the printed date on, July 20, 1953?

Mr. Donahue: Yes.

Mr. Murdoch: Even without looking at it I am going to stipulate that that is the by-laws of the Company.

The Commissioner: That is satisfactory. If in any event, if you discover later, if you discover some error, you can——

Q. May I ask with regard to the by-laws, are the duties of the Treasurer of the DuPont Company listed in the by-laws?

A. Yes.

Q. Are those duties listed on page 11, sir of those by-laws?

A. Yes, running over into 12, yes.

Q. Were those the duties that you performed during the time that you were Treasurer of the Company?

A. Yes.

Q. Do those by-laws also contain the qualifications of [fol. 110] Directors and Officers of the Company?

A. Qualifications?

Q. Yes?

A. I don't understand your question.

Q. Well my question is specifically do the by-laws contain articles with regard to the Officers of the Corporation?

A. Well now, you have changed your question.

Q. And the Directors, I was going to ask you that?

A. The by-laws contain specific or general outline of the duties assigned to each Officer.

Q. Do they contain the same information with regard to the Directors?

A. No.

Q. What information, I refer you to Article II which refers to the Board of Directors; does that article contain various paragraphs with regard to the number of Directors and the manner of election and what their duties are?

A. It contains paragraphs with respect to the number of Directors, how vacancies be filled, places of meeting, regular meetings, special meetings with no reference at all to their duties.

Q. Is there any reference there as to the qualifications of the Directors?

A. No.

[fol. 111] Q. Is there any requirement in the by-laws that a Director own any stock in order to be a Director?

A. No. That is not usually contained in by-laws.

Q. It is not contained in those by-laws?

A. It is not usually contained in by-laws.

Q. It is not, however, contained in those by-laws?

A. That is right.

Q. Would you also—you also stated I believe, that you were a member of the Executive Committee and a Member of the Finance Committee; are the duties of those Committees or Members of those Committees also contained in the by-laws?

A. Yes. And with respect to the Committees there is a generalization as to their duties. A generalization in this way, the Executive Committee is charged with policy responsibility for the operations of the Company and the Finance Committee is charged with matters affecting the financial end of the Company.

Q. Would you characterize the Executive Committee as the top Committee in the DuPont Corporation or the leading Committee in the DuPont Corporation?

A. Mr. Donahue, we use the term for the Finance Committee as the Senior Committee.

Q. And the Executive Committee, how would you characterize that?

A. I can only characterize it as the Committee charged [fol. 112] by the Board with policy responsibility and direction with the operations of the Company as distinguished from Finance.

Q. How long have you been a Member of the Executive Committee, sir?

A. I was elected December 21, 1953.

Q. Have you been a Member of the Executive Committee continuously since that time?

A. Yes.

Q. When were you elected to the Finance Committee?

A. November 1—well at the meeting in October, effective November 1, 1954.

Q. Have you been a Member of the Finance Committee continuously since that time?

A. Yes.

Q. Isn't it true, Mr. Davis, that since 1948 when you became Treasurer of the Company that you have been one of the top Executives with the DuPont Corporation?

A. I think that is a proper statement, yes.

Q. As a matter of fact, is it not also true that you have been the one person with the DuPont Company who is most familiar with its financial situation?

A. No, that is not true. We had Angus Echols, Vice-President of Finance, to whom I reported during my tenure as Treasurer. We had by Eliason a former Treasurer, my predecessor or one time removed, who was an Officer of the [fol. 113] Finance Committee thoroughly familiar, we had Walter Carpenter, Chairman of the Board, one time Vice-President, Chairman of the Finance Committee and the President, not with details, not with how you make entries in a book, not about whether you run a calculating machine or an electronic machine but with finance, finance is something far more comprehensive than bookkeeping.

Q. At least you were one of the few who were most familiar with the financial situation of the DuPont Corporation on the policy making level?

A. I would—I am going to try to make a count but I don't see that it is worthwhile, I was one of let's say fifteen who had sufficient familiarity to be regarded as a top finance man.

Q. Since your election to the Finance Committee isn't it true that you have been the DuPont Officer who has been primarily responsible for the Government—for the Corporation financial policies?

A. No. The Committee as a whole. As a Member of the Finance Committee I have no voice as an individual; I can only act with the Committee.

Q. Does the Committee have a Chairman?

A. Yes.

Q. Who is the Chairman?

A. At the present time Walter S. Carpenter, Jr.

[fol. 114] Q. Have you been Chairman of that Committee?

A. No.

Q. Sir, I refer you to Exhibit A attached to the Stipulation of Facts and I ask you whether or not it is true that your stockholdings in the DuPont Corporation since the time of your first election to the Board of Directors has always been less than at the time of your first election?

A. No, it has not always been less.

Q. When was it greater?

A. It was greater up until March 3, 1955.

Q. How many shares did you have at the time of your election?

A. 2,842.

Q. What was the date of your election, sir?

A. December 21, 1953.

Q. And at that time you held 2,842 shares?

A. That's right.

Q. And then at the time of the election in 1955 how many shares did you own?

A. At the time of the election in 1955, 3,081 shown on the proxy statement. I think that is right.

Mr. Murdoch: Are we talking about the election or the annual stockholders' meeting?

Mr. Donahue: Excuse me, I am sorry, I meant the annual stockholders' meeting.

[fol. 115] The Witness: Was your question in 1955 or 19——

Q. I meant at the time of the annual stockholders' meeting?

A. In 1955?

Q. 1955?

A. 3,081 shares.

Q. What was your holding at the proxy time of the annual stockholders' meeting in 1956?

A. 2,618.

Q. And by the way, in what month is the annual stockholders' meeting?

A. April.

Q. In April?

A. The listed holdings are as of the end of the preceding year as required by the S.E.C.

Q. I see. But in April, 1956 your stockholdings would have been 2,081 shares, is that correct?

A. I mentioned in my testimony a while ago that I made that delivery of 500 shares to Mrs. Davis, the ex-Mrs. Davis, in order to avoid that showing.

Q. The showing in the proxy statement was as of the end of the previous calendar year?

A. That's right.

Q. Now as of the time of the stockholders' meeting in [fol. 116] 1957 what were your share holdings?

A. 2,304, that is as shown on the proxy.

Mr. Murdoch: I question the pertinency of these discussions about Mr. Davis, stockholdings after 1953, which is what we were talking about when the agreement was entered into, 1954.

Mr. Donahue: Mr. Davis, of course your Honor, has contended that he could not afford to lose stock in the Corporation and still maintain his position.

The Commissioner: Well the record may stand. You may proceed.

Q. Mr. Davis, again referring to Exhibit A, I note during the year 1954 under the column, "Shares Out," you apparently disposed of 400 shares of stock, is that correct, sir?

A. That is right.

Q. Can you state at this time what the purpose was or what was the occasion of that disposition of stock?

A. 200 shares were sold to pay income taxes and 200 shares were sold to meet the cash demands of the ex-Mrs. A. M. Davis.

Q. Were you not afraid at that time that the stock which was sold to meet the demands of Mrs. Davis might affect your position with the Company?

A. Yes.

[fol. 117] Q. Nevertheless you sold the stock?

A. Yes. I had to. And the proportions are what we call sometimes the minimum. In other words I had no choice.

Q. In March 21, 1956 according to Exhibit A attached to the stipulation, you disposed of 100 shares of stock; if you can recall, sir, what was the occasion of that disposition?

A. To pay income taxes.

Q. The payment of your income taxes was considered by the Company to be a legal obligation which apparently had no effect on your position with the Company, is that true?

A. That explanation was always acceptable.

Q. Do you have any reason to think that the same explanation might not be acceptable in view of the fact that a divorce proceeding also presents one with a legal obligation?

A. It might have been acceptable to my colleagues in our

inner sactum sanitorium who understood me, but it would not be acceptable on the shareholders' floor.

Mr. Murdoch: I think you have assumed something that is not the fact. At the time this grant was made there was no divorce action pending. You are talking about the resistance.

Mr. Donahue: I am not assuming that at all.

Mr. Murdoch: It was a hypothetical?

Mr. Donahue: Certainly.

Q. Mr. Davis, your separation agreement was of course [fol. 118] incorporated into the divorce decree, was it not?

A. Yes.

Q. Is it true that this question of the disposition of your shares of stock was never presented to the stockholders?

A. Yes. And by virtue of the way I managed it.

Q. Would it not have been equally as possible to give Mrs. Davis another 500 shares a year later and still have had no effect on the position with your Company?

A. I don't think so.

Q. Did you not receive a stock bonus each year at the beginning of the year?

A. Well you have the instance there, they tell you what I receive.

Q. Are these various instances stock bonus?

A. All bonuses.

Q. Did you make any attempt to purchase any stock on your own?

A. I can't. I had no funds. May I make a parenthetical statement? I own no stock that did not come to me by way of bonus.

Q. Despite the fact that your stockholdings were somewhat reduced in the years 1955, 1956 and 1957 have you always been included upon the Company's proxy statement as a Director?

[fol. 119] A. Since election, yes.

Q. Since your first election?

A. Uhm hmm. Now I want to—may I call your attention to the fact that the dispositions in 1957 are insignificant, they were contributed to a charitable institution by virtue of not having any funds. As you included in your question my dispositions in 1955, 1956 and 1957, those dis-

positions in 1957 are so minor as to hardly be included in your question.

Q. Nevertheless they did tend to reduce your overall stockholdings?

A. Thirty-two shares.

Q. For those years. Yes sir. Now Mr. Davis, isn't it true that there have been a number of other Directors of the DuPont Corporation that had stockholdings somewhat comparable to yours in amount?

A. Other Directors somewhat comparable, yes. On the order of 3,000 shares.

Mr. Donahue: Would you mark these for identification as Government Exhibits 2, 3, 4, 5, and 6, in that order?

(Photostat of 3-page paper headed "Shareholdings (of record and beneficial interest) of DuPont Company common stock by the Directors for selected years" was marked Defendant's Exhibit No. 2.)

[fol. 120] (Printed letter size booklet of E. I. du Pont de Nemours and Company notice of annual meeting and proxy statement etcetera, dated March 14, 1955 was marked Defendant's Exhibit No. 3.)

(Printed letter size booklet of E. I. du Pont de Nemours and Company notice of annual meeting and proxy statement etcetera, dated March 9, 1956 was marked Defendant's Exhibit No. 4.)

(Printed letter size booklet of E. I. du Pont de Nemours and Company notice of annual meeting and proxy statement etcetera dated March 8, 1957 was marked Defendant's Exhibit No. 5.)

(Printed letter size booklet of E. I. du Pont de Nemours and Company notice of annual meeting and proxy statement etcetera, dated March 14, 1958 was marked Defendant's Exihibit No. 6.)

Mr. Donahue: The proxy statements are from 1955 through 1958.

Mr. Murdoch: Dated March 14, 1955?

Mr. Donahue: Yes.

Q. Mr. Davis, I show you what has been marked for purposes of identification as Defendant's Exhibit No. 2 and ask you if you recognize that?

A. Yes.

Q. Would you state for the record, sir, what that is?

[fol. 121] A. Well it is a compilation of the ownership of record—or beneficially of DuPont shares on the proxy statement for each of the years, 1952, 1953, 1954 and 1958.

Q. Now referring to Defendant's Exhibit 2 would you state the holdings of the following Directors, C. A. Cary?

Mr. Murdoch: Your Honor, if we can shorten it I will stipulate that this can be admitted as an exhibit.

The Commissioner: That will be sufficient.

Mr. Murdoch: Get it on the record that way.

Mr. Donahue: That will be sufficient, yes sir.

The Commissioner: All right.

Mr. Donahue: Is that as to Defendant's Exhibit 3 through 6 which are the proxy statements?

Mr. Murdoch: I thought this was two.

Are you asking to read from the proxy statement?

Mr. Donahue: No, I asked him to read from Defendant's Exhibit 2.

Mr. Murdoch: I am stipulating that this can go into the record and save Mr. Davis' reading from it.

Mr. Donahue: That is agreeable. I also wanted to put into the record Defendant's Exhibit 3 and 6 and I was going to ask somewhat similar questions with regard to those of Mr. Davis.

[fol. 122] The Commissioner: All right, Defendant's Exhibits 2 through 6 are received in evidence.

(The photostat entitled "Shareholdings (of record and beneficial interest) of DuPont Company common stock by the Directors for selected years" was received in evidence as Defendant's Exhibit 2.)

(Printed letter size booklet of E. I. du Pont de Nemours and Company notice of annual meeting and proxy statement etcetera, dated March 14, 1955, one dated March 9, 1956, one dated March 8, 1957, and one dated March 14, 1958, were received in evidence as Defendant's Exhibits 3 through 6 respectively.)

Mr. Donahue: I forget whether I offered Defendant's Exhibit 1. If I haven't, I would like to offer it, that is the by-laws.

The Commissioner: I believe it was received. If there is any doubt, I will now indicate on the record that Defendant's Exhibit No. 1 is received in evidence.

(The printed booklet entitled "By-laws of E. I. du Pont de Nemours and Company dated July 20, 1953," was received in evidence as Defendant's Exhibit No. 1.)

Q. I would like to ask you a couple of questions: was Mr. C. A. Cary a Member of the Executive Committee in 1958?

A. Yes. He retired in that year I think.

Q. Was Mr. J. W. Kinsman a Member of the Executive [fol. 123] Committee in 1958?

A. No. He resigned before 1958. It must have been 1957.

Q. Was he a Member of the Executive Committee in 1957 or prior to that?

A. Yes.

Q. Was Mr. W. H. Ward a Member of the Executive Committee?

A. Yes.

Q. Mr. Roger Williams, was he a Member of the Executive Committee?

A. Yes.

Q. Would you state whether any of these gentlemen were Members of the Finance Committee?

A. No one of them were members of the Finance Committee.

Mr. Donahue: Would you mark these for identification as Government's Exhibits 7, 8, 9, 10, 11, 12 and 13, which purport to be income tax returns of the Plaintiff for the years 1949 through 1955.

(Photostats of income tax returns, Form 1040, for Thomas Crawley Davis and Alice M. Davis for the years 1949, 1950, 1951, 1952, 1953, 1954 were marked Defendant's Exhibits 7 through 12.)

(Photostat of income tax return, Form 1040, for Thomas [fol. 124] Crawley Davis and Grace Ethel Davis for the year 1955 was marked Defendant's Exhibit 13.)

Mr. Morford: I think they could be admitted without further identification.

The Commissioner: Defendant's Exhibits 7 through 13 are received in evidence.

(The Exhibits recited above were received in evidence as Defendant's Exhibits Nos. 7 through 13.)

Q. It is curious to me, Mr. Davis, I should have asked you one other question with regard to what has been marked for identification as Defendant's Exhibit 2—isn't it true that at least with respect to the year 1958 there were several Directors that had holdings substantially less than your own holdings of stock?

A. Two I think.

Q. Who were those two, sir?

A. D. H. Dawson and R. L. Hershey.

Q. And now I show you what has been——

A. No. Is it permissible for me to add to it that——

Mr. Murdoch: Certainly, give a complete answer.

The Witness: I want to remind you that neither were elected to the Finance Committee or slated to the Finance Committee. I also want to remind you that each are top flight scientists, Doctors in general engineering whose services the Executive Committee desperately needed.

[fol. 125] Q. Isn't it also true, Mr. Davis, that you are a top flight accountant and are completely familiar with corporate finances?

A. I cannot praise myself. I regard myself as completely familiar. I am told fifteen minutes ago that there are fifteen other persons in the Company completely familiar.

Q. However, you yourself are a C. P. A., are you not?

A. Yes.

Q. And you have taught accounting in college?

A. Yes.

Q. I show you what has been entered into evidence as Defendant's Exhibits 7 through 13, which purport to be, which are your income tax returns for the years 1949 through 1955; now is it not true that your income increased during each of those years?

A. I suppose that is true, yes.

Mr. Murdoch: Are you talking of the gross or net? What are we talking about when you say your income?

Mr. Donahue: Well we will say your gross income increased during those years.

The Commissioner: You don't have to ask him a question about what is obviously shown on there.

The Witness: I don't know that those are photostats. [fol. 126] I know that they purport to be. So I suggest that you not ask me questions of that kind.

Mr. Murdoch: We have agreed that he can admit them as copies. We assume they are.

Q. Would you care to examine them to determine whether there has been an increase in your income?

The Commissioner: Why don't you let me examine them. I mean when he case is submitted on the record. They are admitted to be copies of his returns.

Mr. Donahue: I was leading into another question.

The Commissioner: All right.

Q. Again we will assumee that there was an increase, which the returns themselves show, to what was that increase attributable?

A. Increased responsibility. Some increase in salary, perhaps some increase in bonus.

Q. Is your bonus considered part of your salary, sir?

A. For this purpose it is (indicates). It is not in the Company.

Q. Now you were Treasurer of the Company until December 1953, is that correct?

A. That's right.

Q. Were you receiving a stock bonus until that time?

A. Yes.

Q. That was based on your work as Treasurer of the [fol. 127] Company?

A. That's right.

Q. And when you became a Director you do also receive a bonus?

A. Yes.

Q. As a Director?

A. No. As Vice-President and Member of the Executive Committee, not as a Director.

Q. How much do you receive as Director's fees?

A. $100. a meeting.

Q. And how many meetings are held a year?

A. Fifty-two. No, no, no. Twelve. I have the Executive Committee meeting——

Q. Then your increases in salary over the years were attributable primarily to increase in salary, which of course includes bonus?

A. And increased responsibility. For instance in the office of Treasurer I received less than I received as the Vice-President.

Q. What was your salary as Treasurer?

A. Including——

Q. Including bonus?

Mr. Murdoch: I think that is obvious from the return.

Mr. Donahue: No, I don't believe it is.

[fol. 128] A. I wish you would get it from the return.

The Commissioner: It is obvious in the returns, isn't it?

Mr. Donahue: I don't believe it is broken down, your Honor, well between——

The Commissioners: Oh, I see.

Mr. Donahue: It isn't broken down as to the regular salary and the bonus. Maybe if I can clarify by this question——

Q. On your returns under wages or salary, do you include both, what we would term salary as well as your bonus payments?

A. Yes, you are supposed to.

Q. In 1949 you have a return, you have total wages $86,117.43, that would include both?

A. That is right, bonus delivered that year and the salary.

Q. The one bonus varies in different years?

A. Yes, depending on the profits, depending on performance. Sometimes I am not as good as I was the year before.

Q. What is the difference between the bonus you receive as a Member of the Executive or Finance Committee and the bonus you receive as Treasurer of the Company?

Mr. Murdoch: You are asking dollar amounts or a dif-
[fol. 129] ferent series?

Q. —different series and dollar amounts, if you will?

A. I can't give you dollar amounts because, as I have said, they vary from year to year depending on the fund. There has been another factor and that is that we have changed the bonus plan in the last two years, so that members of top management get some bonus in stock or cash, offhand cash and so much in dividends equivalents. Let me say this: that roughly twice my present position yield me an income, roughly twice what my Treasury position did.

Q. Is that as of this year?

A. Well I prefaced my statement by saying that I can't from memory dot each year, for instance, the bonus this year is much less because the bonus the preceding year—because 1958 was a dull year. What I have to say is that my present position and responsibility I will probably fetch about twice what I would in the Treasurer's position. If that is not satisfactory I will have to go back and look it up and I don't see what——

Mr. Murdoch: I am not clear on what we are leading to here. I think probably a lot of this is in the returns. Mr. Davis' income has steadily increased. I don't see what we are proving.

Mr. Donahue: I think I have exhausted what I wanted to on this particular line.

[fol. 130] The Commissioner: All right.

Q. Mr. Davis, you stated that you were expected to save the bonus stock, I would like to know by whom you were expected?

A. By a traditional policy of top management of the Company.

Q. Isn't that top management policy, as you say, directed more to the fact stock should be given to the various Company Executives to make them more interested in the Company rather than to the fact that they should retain such stock?

A. It is directed to both. I don't know whether you will permit me to read this or not, you probably won't, you will probably object to it.

Q. I probably will, but what are you referring to?

A. Crawford Greenewalt's statement at a speech in Co-

lumbia University a year ago, "Traditional Bonus awards were made in the form of common stock of the Company. It was presumed that the employee will use his salary for living expenses and accumulate his bonus stock or savings as a stake in the Company's future. Until recently this was the common practice among bonus recipients and I have heard many men say with some pride that they never sold a share of bonus stock."

Q. And of course he says "recently" that that was the Company policy?

A. Well——

[fol. 131] Q. The Company policy obviously has changed, is that correct?

A. No, the circumstances have changed by reason—virtue of the large tax bite. That is all in here. But I don't want to bore you with all that, and you won't let me anyhow.

Q. I asked you to explain the words "until recently"?

A. That has reference to the fact that only, and lately would be a decade, the tax bite is so large, you saw some of my dispositions, they wouldn't have been made except for the fact that I had to raise cash to pay the tax.

Q. You made a disposition of 1,000 shares of stock, yet you are still a Director of the Company, isn't that true; sir?

A. Yes.

Q. Yet you say you could not have made a disposition of 1,500 shares and remained a Director of the Company?

Mr. Murdoch: I am not sure that was his testimony.

Mr. Donahue: Well he can answer the question now.

The Commissioner: I don't think he has testified that he couldn't possibly remain.

Mr. Donahue: Let me rephrase it.

Q. Would you say then, that you could not have disposed [fol. 132] of 1,500 shares and still remained a Director?

A. No. I will say this, that I could not dispose of 1,000 shares or 1,500 shares all at one time and have remained a Director or been elected to the Finance Committee.

Q. But you could have disposed of 1,500 shares over a period and remained a Director or a Member of the Finance and/or a Member of the Finance Committee?

A. I can't say dogmatically no. I can say that I have grave doubts that I could.

Q. Was one of your reasons for hiring Counsel to represent you in this matter, the fact that you personally would experience adversity in meeting your payments in maintaining your customary style of living, whatever that might be?

A. I don't understand that question.

Q. Well I am merely trying to ascertain whether one of the reasons you hired Mr. Young was to protect your personal interests—in other words, in order to maintain your home in the way that you had been living, the customary way in which you had lived?

A. There was no other way to dispose of the problems before me except by a competent legal Counsel. My primary interest was the protection of my job, my position, and if that were done everything else would fall in place. If that were not done, my being a C. P. A. couldn't help me.

[fol. 133] Q. Now you stated that you consider that your wife's attitude was cold and hostile; did this cause you a great deal of personal discomfort?

A. I mentioned that I spent a good deal of time in the hospital. I was a wrecked man. I didn't want to dwell on that too long. But if you want to cross examine in detail.

Q. I don't care to dwell on it at length.

A. I have not yet recovered my health.

Q. That was due——

A. To the emotional upset caused by that very unhappy thing.

Q. Just one more question on that point, sir. Would you say that at the time of the separation agreement that your personal relations with your wife had become unbearable? That would be as of November, 1954?

A. They would have been borne, they were undignified. People cannot or should not, people of culture, of standing and reason and judgment should not live under those circumstances for any great length of time.

Q. Your testimony I believe, was to the effect that as of September, 1954 you had realized that you had lost the battle?

A. That's right. Lost the battle in terms of bringing

her to a reconciliation, which would accept the fact that I would have to keep stock in my name, 2-or-3,000 shares.

[fol. 134] Q. Now just to clarify that point for a moment. Was all of your DuPont stock in your name, sir?

A. Always.

Q. Is it true that your employment or part of your employment of Mr. Young was to arrange for a divorce?

A. No. Mr. Young—I could have gotten a divorce for $600. Divorce is no problem.

Q. Isn't it true that Mr. Young made the arrangements for you to obtain Attorneys in Reno?

A. Well he did the telephoning and obtained the Attorney.

Q. Was there an agreement as to the grounds for divorce?

A. No.

Q. There was, however, an agreement that a divorce would be obtained, is that it?

A. I stated in my previous testimony that that situation was reached about November of 1954.

Q. You were present in the room here and you said that if this separation agreement would not have been, or you heard Mr. Young testify that the separation agreement would not have been entered into, if it had not been agreed that it would be incorporated in the divorce?

A. I think that was an act which strengthened it. I thought considerable about it. We had never talked about [fol. 135] it exactly in that light. And this is the reason: I owed Mrs. Davis nothing; I was maintaining a home for her on all proper standards, and she insisted on breaking it up. And I have related to you the manner in which she used me, which over a period of months, coming to a close or perhaps coming to a conclusion perhaps about the time of the signing of the agreement, I came to the conclusion that a divorce was the only way that I had of continuing to live. Therefore I think—I think it proper to say although we didn't talk about it, because we didn't have to, I left that to Young, it is proper to say that if she had dug her heels in, I would have dug my heels in. In other words, I did not feel that I could stand what I saw coming under a separation agreement without legal separation.

Q. Did you have any discussion at all with Mr. Young relative to the grounds for divorce?

A. No.

Q. As to the jurisdiction in which the divorce should be?——

A. Oh, no.

Q. —obtained. As to whom the moving party would be?

A. I think my recollection is dim but I think there was a few words exchanged between us that it would be quite embarrassing for me to leave the State and take residence in another State for that length of time, and therefore it [fol. 136] would seem reasonable in all the circumstances, that is to say I have been forced into things that I did not want, that Mrs. Davis should be the moving party.

Q. Did you pay for Mrs. Davis' stay in Reno?

A. Yes, Mr. Morford was able to get that from me.

Q. Well, bringing up the question of Mr. Morford's fees, what was the occasion of—strike that. Did you agree to pay your wife's fees to Mr. Morford?

A. I understood that I had to, so I did.

Q. By whom were you——

A. By Mr. Young and by Mr. Morford.

Q. As a result of their advice you paid the fees?

A. That's right.

Q. To Mr. Morford?

A. That's right.

Q. Mr. Morford, of course represented your wife?

A. Yes.

Q. What discussions, if any, did you have with Mr. Young relative to the custody and support of your son?

A. Not very much. It was perfectly clear to me that if the home was to be broken, that the child shouldn't be broken in half. Mrs. Davis wanted custody and support and I acquiesced with a heavy heart in consideration for the youngster. I don't think that there is anything more difficult for a youngster than to——

[fol. 137] Q. Would you——

A. —spend three months with Dad and three months with M. ma.

Q. Would your answer be the same sir, with regard to the education of your son?

A. Yes. But for a slightly different reason. I realize that if I had a hand, if I obtained a voice or a right to a voice in his education by a decree, by a written paper, that we would always be bickering about it and I wanted to remove bickering from the child's life.

Q. Did you have any discussion with Mr. Young relative to the retention by you of your home?

A. Why was there any necessity?

Q. As I understood from your testimony, Mrs.—the former Mrs. Davis claimed half the value of—half the home?

A. Yes. But she wanted it in money. There was no question of me not retaining my home if I had the money. Does that answer your question?

Q. It was just a question of your raising the money to equal half the value of the home?

A. Yes.

Q. Was there any negotiation on your part as to the personal belongings, the furniture, silver, things of that sort?

A. Mr. Young stated it this morning.

[fol. 138] Q. Mr. Young's statement was to the effect that you were willing to——

A. That I said let her have what she wants. She made a list, I didn't even require that, but the Attorneys thought it best.

Q. Did you discuss with Mr. Young at any length the problem of the amount of support for your wife?

A. At some length, yes. But only a part of the negotiations. Part of his preparation for the negotiations, I will put it that way.

Q. When did the actual divorce take place approximately sir?

Mr. Morford: I believe that is in the stipulation. Paragraph 9 of the stipulation. January 5, 1955.

A. Uhm hmm.

• • • • • • •

[fol. 139] By Mr. Donahue:

Q. Now Mr. Davis, at the time you entered into the [fol. 140] separation agreement did you personally feel an obligation to support your wife?

A. No.

Q. You felt no obligation at that time?

A. No.

Q. Is it not true then that you entered into the separation agreement primarily to be rid or as the first step in getting rid of your wife and her demands?

A. No, I answered that before, I entered into it under duress.

Q. You wanted no part of entering into the separation agreement?

A. I did not.

Q. But you did enter into it?

A. I did.

Q. You entered into it as a means of getting out of a bad situation?

A. I entered into it upon the advice of Dr. Hughes and Hy Young after their discussions with Morford and Dr. Munson and I made every possible effort. I engaged the best Counsel I possibly could to help me to bring this thing around. I entered into it after I had been told that there is no way to save this marriage.

Q. At the time you decided there was no way to save this marriage, you also decided that you had to be divorced [fol. 141] from Mrs. Davis?

A. Mr. Donahue, I have gone through that. My answers were complete, I hope were complete. If they weren't you may pursue it further.

Q. Mr. Davis, in the normal course of corporation procedure, would you just describe briefly the method by which the Directors are elected?

A. Well I think first and foremost they are elected each year at the annual stockholders' meeting, having been proposed usually by the management; and vacancies on the Board between meetings, annual meetings of the shareholders, according to the by-laws can be filled by an election by the Directors.

Q. You state that the Directors are proposed by the management?

A. The proxy statement will give *you* that to you clearly.

Q. Since your first election have you always been proposed on the DuPont proxy statement?

A. Yes.

Q. Isn't it true that in the DuPont corporation merely if one is listed in the proxy solicitation or stipulation that it is paramount to election?

A. I don't know any exception to election, I wouldn't want to adopt your exact language.

[fol. 142] Q. However, you do know of no exception to to that rule?

A. I know of no exception. I know of some adverse votes but they weren't enough to carry.

Mr. Donahue: I think that will be all.

Mr. Murdoch: I have a very few.

The Commissioner: All right.

* * * * *

[fol. 143] Mr. Murdoch: Your Honor, we have already introduced the bill of Mr. Young and I have with me copies of Mr. Morford's bill. I think I can include these bills and their payments through Mr. Davis as well as I can through Mr. Morford. Do you have any objection if we just submit these bills?

Mr. Donahue: I do. I object to the admission of these bills in evidence, your Honor, otherwise that actually the amounts themselves have been stipulated to in the stipulation, and that the characterization of the payments is made by Mr. Morford and I feel that he should be required to testify as to what the professional services consisted of.

Mr. Murdoch: I am not introducing them to prove that these were the correct descriptions. I am introducing them to prove that Mr. Davis got these bills and paid them.

The Commissioner: For that limited purpose then these exhibits will be received in evidence as what number? 5 and 6.

[fol. 144] (Copy of letter dated January 27, 1955 addressed to J. R. Morford Esq. and attached thereto a bill of Morford and Bennethum dated December 16, 1954 for professional services with tax matters was received in evidence as Plaintiff's Exhibit No. 5.)

(Copy of letter dated January 27, 1955 to J. R. Morford Esq. and attached bill of Morford and Bennethum dated December 16, 1954 to Mr. T. Crawley Davis for profes-

sional service in the matter of division of property and preparation of separation agreement was received in evidence as Plaintiff's Exhibit No. 6.)

Q. Mr. Davis, I show you Plaintiff's Exhibit 5; will you tell the Court what the purports to be?

A. Professional services rendered by Mr. Morford in connection with tax matters involved Alice M. Davis versus T. Crawley Davis.

Q. That is a bill received by you from Mr. Morford?

A. Yes, in my office at 9016 DuPont Building.

Q. Did you pay this bill?

A. Yes.

Q. Do you recall when you paid it?

A. Part in November and part in January. I was short of cash and I had begged these people to give me——

Q. November, 1954 and January, 1955?

A. Yes.

Q. I show you Plaintiff's Exhibit No. 6. Will you state [fol. 145] what that bill is that Mr. Morford recites?

A. Morford, professional services in the matter of division of property and preparation of separation agreement between T. Crawley Davis and Alice M. Davis, $5,000. Paid the same way.

Q. That bill was received by you from Mr. Morford?

A. Yes, 9016 DuPont Building.

Q. Was that paid by you?

A. Yes.

Q. When did you pay it?

A. November, 1954 and January, 1955.

Mr. Murdoch: Any other questions?

Mr. Donahue: I think that would be all.

The Commissioner: That is all, Mr. Davis.

Now let's go off the record.

(Off the record.)

Nicholas J. Bartolone, having been sworn, was examined and testified as follows:

Direct examination.

By Mr. Donahue:

Q. Would you state your name and address, please?

A. Nicholas—my name is Nicholas J. Bartolone; I live at Lenni Mills, Pennsylvania.

Q. What is your employment?

A. I am employed as an Internal Revenue agent in the [fol. 146] Office of the District Director, Wilmington, Delaware.

Q. How long have you been so employed?

A. Approximately four years.

Q. During your work as Internal Revenue agent have you had or did you have occasion to audit the income tax return of the Plaintiff, Mr. Davis, for the calendar year ending 1955?

A. I did.

Q. As a result of your audit of that return did you determine or set up a deficiency?

A. I did.

Q. Would you state upon what grounds that deficiency was based?

A. I proposed that disallowance of certain legal expenses; in addition to that I applied—I proposed an application of capital gains tax on the appreciated value of securities over his cost basis that were transferred to Mrs. Alice M. Davis.

Mr. Donahue: Now would you mark this as Defendant's Nos. 16 and 17?

(Copy of letter and two-page statement dated September 27, 1957 from the Appellate Division of the Internal Revenue Service to Mr. Thomas Crawley Davis and Mrs. Grace Ethel Davis was marked Defendant's Exhibit 16.)

[fol. 147] (A typewritten letter size sheet with the figure 5 at the top and headed Thomas Crawley and Grace Ethel Davis Exhibit A, year ended 12/31/55 was marked Defendant's Exhibit No. 17.)

Q. I show you what has been marked for identification purposes as Defendant's Exhibit No. 17 and ask you to identify that?

A. Yes sir, I can.

Q. What is that?

A. This is a copy of my computation of the additional income adjustment as a result of the transfer of 500 shares of the stock to Mrs. Alice M. Davis.

Q. Where, referring to Defendant's Exhibit No. 17, where did you obtain the figures as to cost?

A. Those were provided by Mr. Davis; he provided a list showing the certificate numbers, the date of acquisition, and his basis.

Q. I show you Exhibit B attached to the petition in this case and ask whether that is the schedule that you are referring to?

A. Yes it is.

Q. Now referring again to Defendant's Exhibit 17, upon what did you base the column "Selling Price?"

A. That was obtained by going to the March 22, 1955 edition of the Wall Street Journal and by getting the mean of the high and low for the day of March 21st for the DuPont [fol. 148] common stock.

Q. If you can recall, what was that mean?

A. 164½.

Q. In obtaining the selling price did you just multiply the number of shares times the mean value per share?

A. Yes sir.

Q. Would you examine the middle of the page where it says 112 shares DuPont common, and state whether that is an error on that exhibit?

A. The number of shares here is in error; the amount of —the dollars and the selling price is not in error.

Q. What should the number of shares be?

A. 162 shares.

Q. Now I show you what has been marked for identification as Defendant's Exhibit 16 and ask you to state what that is?

A. This is a 90 day letter that was issued by the Appellate Division of Philadelphia.

Q. Attached to that 90 day letter is there a report showing the adjustments which you had made in Mr. Davis' return for that year?

A. Yes sir.

Mr. Donahue: I offer both of those exhibits into evidence.

Mr. Murdoch: No objection.

[fols. 149-151] The Commissioner: Defendant's Exhibits 16 and 17 are received in evidence.

(Copy of Appellate Division of Internal Revenue Service's letter dated September 27, 1957 to Mr. Thomas Crawley Davis and Mrs. Grace Ethel Davis and two-page statement attached thereto was received in evidence as Defendant's Exhibit No. 16.)

(Letter size type written sheet with figure 5 and Thomas Crawley and Grace Ethel Davis at the top and headed Exhibit A, year ended 12/31/55 was received in evidence as Defendant's Exhibit No. 17.)

Mr. Donahue: I think that will be all.

* * * * * * *

[fol. 152] IN THE UNITED STATES COURT OF CLAIMS

Washington, D. C., Thursday, June 18, 1959
10:00 o'clock a.m.

**Transcript of Testimony of June 18, 1959**

The above case was resumed, pursuant to notice of the Commissioner, at the time above stated, in Hearing Room No. 1, United States Court of Claims, Washington, D. C.

Present: Hon. Roald Hogenson, Commissioner.
Converse Murdoch, Esq., Counsel for the Plaintiffs.
Peter Donahue, Esq., Counsel for the Defendant.

(Mr. D. F. King, reporter, was sworn by the Commissioner.)

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[fol. 153] JAMES A. MARFORD, a witness produced on behalf of the Plaintiffs, having been first duly sworn by said Commissioner, was examined and testified as follows:

Direct examination.

By Mr. Murdoch:

Q. Will you state for the record your name and address?
A. James R. Marford; 2311 Gap Turnpike, Wilmington, Delaware. Office address 14th Floor, Bank of Delaware Building, Wilmington.
Q. What is your profession?
A. I am an attorney-at-law.
Q. And how long have you been an attorney?
A. 37 years.
Q. During that 37 years have you been engaged in the private practice of law in Wilmington?
A. Yes.
Q. During your 37 years in the practice of law have you had experience on matters relating to marital separations, divorce practice, property divisions between husbands and wives?
A. Yes, many of them.

Q. During 1954 were you retained by Alice M. Davis [fols. 154-158] to represent her?

A. I was.

Q. Will you describe for the the Commissioner the circumstances surrounding your retention and the sort of work Mrs. Davis asked you to do for her?

A. Mrs. Davis came to see me in the week preceding June 15, 1954; related to me the marital situation and stated she wanted a property settlement, and from there I took over and negotiations ensued.

I may say that Mrs. Davis first outlined to me her primary demands with certain alternatives, which I communicated to Mr. Young, who within a few days I had been advised represented Mr. Davis.

Q. Do you recall whether Mrs. Davis' demands at that time involved the Du Pont Company stock owned by Mr. Davis?

* * * * *

[fol. 159] By Mr. Murdoch:

Q. Mr. Marford, in connection with your representation of Mrs. Davis did you make any demands on her before to Mr. Davis or his attorney relating to Mr. Davis' holding of the du Pont Company stock?

A. I did.

Q. Could you tell us what the nature of those demands were?

A. Only as related to the du Pont stock?

Q. For the moment, yes.

A. That Mrs. Davis received 1500 shares of the common stock of the E. I. du Pont de Nemours & Company unconditionally. I may add plus a sufficient annual sum to pay interest on an insurance loan then existing at the Farmers' Bank. I mention that because it is tied in with the 1500 [fol. 160] share proposition.

Q. Were there any other demands relating to Mr. Davis' property passing du Pont stock?

A. Yes, that she was to receive one-half of the appraised valuation of the home and the furnishings, that she was to keep a certain automobile, one of two cars, and I don't

remember how they were titled at the time, but, in any event, she was to have one of the two cars.

Q. We have in the record already the separation agreement dated November 4, 1954. I assume that between the time of your initial demands on behalf of Mrs. Davis and the execution of this agreement, there were conferences between you and Mr. Davis' attorney, and if so could you describe somewhat the negotiations between them?

A. I have detailed contemporaneous notes in longhand made with respect to each conference. Do you want me to go into each conference and tell you how the matter went from one point to another until it culminated in the agreement of November 4, 1954?

Q. I think you could summarize for us without getting into too much detail, to show what the work was you were called upon to do.

A. I communicated Mrs. Davis' initial demands to Mr. Davis' attorney on July 13, 1954. Those demands include the items to which I have just testified.

[fol. 161] The day previously I had had another talk with Mr. Young, at which time he made his suggestion on behalf of Mr. Davis that effort be made for reconciliation. After a conference with Mrs. Davis that was finally rejected on August 23, 1954.

After receiving Mrs. Davis' initial proposition Mr. Young, on Mr. Davis' behalf, made a counterproposal on August 24, 1954, which embodied a number of items, but generally, and to summarize, I would say that his proposition called for the payment of what may be termed alimony on a periodic payment basis of over ten years or more in lieu of a division of property. That I would not accept because of the—this was on the 24th of August—because of the provisions of the 1954 code, No. 71, and similar provisions of the 1939 code, 22-k.

Then I advised Mr. Young on August 25th that that would not be satisfactory and I advised him specifically that Mrs. Davis takes the position that this should be a property settlement and not alimony, and in making that statement I am reading from my note made in longhand at that time.

I had another conference with Mr. Young on August

26th, and I can detail the many conferences we had but I have in mind the changes in the picture that took place up to the time the agreement was executed.

[fol. 162] We finally reached a point where there was agreement on Mrs. Davis' part to take 1,000 shares instead of 1,500 shares of du Pont stock. At that time Mr. Davis' stockholdings had been disclosed and my recollection is they were 3,200 and some shares. I have a note in my file.

Mr. Davis' first proposition with respect to the 1,000 shares, which was some time in October, was to pay that or to turn over the thousand shares in this fashion: 500 shares immediately by gift, 250 shares in 1955, 250 shares in 1956.

On Mrs. Davis' behalf I turned that down unless Mr. Davis would agree to a clause in the contract by which he would agree by way of further gift to pay the amount of any tax that would be applicable to the 500 gift shares in the event of their subsequent sale by Mrs. Davis.

After receiving that proposition, which was written out in the form of a draft in a letter, he then came back with the proposition that we finally agreed, which was, after all, a compromise between our initial viewpoints, and Mr. Davis to transfer to Mrs. Davis 1,000 shares, 500 in 1954 and 500 in 1956, and to make certain monetary payments to her for a limited period of time which would not make them taxable to Mrs. Davis and deductable by Mr. Davis under the provision of the tax law, and that is what was carried out, as I recall, in the agreement.

[fol. 163] Q. Mr. Marford, during the course of this work did you take any steps on behalf of Mrs. Davis in the way of starting action for divorce?

A. I did not.

Q. You alluded to tax problems which were involved in these negotiations. Could you elaborate on that a little more and tell us what tax problems you encountered?

A. Well, so far as Mrs. Davis was concerned, I was, of course, vitally concerned with the alimony provisions of the tax law, 22-K of the 1939 Code, and No. 71 of the 1954 Code, because any payments that were made to her I wanted to avoid them being taxable to her if I could, and then when the time came when Mr. Davis made the proposition

of 500 shares by way of gift then I was concerned. May I look at my notes, Your Honor?

Commissioner Hogenson: Yes, you may.

The Witness: What I am trying to find is my note as to the section of the Code applicable to taxable gains. I have it here.

Commissioner Hogenson: Take your time, Mr. Marford.

The Witness: And it was stated concisely in the letter to Mr. Young—in any event, in a letter I wrote to Mr. Young, Mr. Davis' attorney, on November 28, 1954, I commented quite at length about the tax situation in which Mrs. Davis would be involved if she received the 500 shares [fol. 164] by way of gift and later sold those shares, and it was in that letter that I suggested the provision for a further gift by way of cash to pay any capital gains tax on those shares, but some research was done in my office, either by me or one of my associates, on the applicable section and decisions under that section.

So, I may say on behalf of Mrs. Davis I was concerned taxwise with Section 71 and 215 of the 1954 Code, 22-K of the 1939 Code, and the provision relating to capital gains, and that was the section number that I was looking for. I can't seem to pick up for the moment and I have forgotten it.

Q. Mr. Marford, at the previous hearing there were adduced in evidence bills from you dated December 16, 1954. These were Plaintiffs' Exhibits Nos. 5 and 6. Can you identify those as your bills?

A. I can. They are my bills.

Q. Do you recall whether Mr. Davis paid those bills to you?

A. He did.

Q. Throughout the controversy between Mr. and Mrs. Davis you represented only Mrs. Davis; is that correct?

A. That is correct. And, of course, through Mrs. Davis the interests of the son whose custody was conceded her from the beginning.

[fol. 165] Q. Nevertheless, your bill for services at that time was submitted to Mr. Davis?

A. That is correct.

Q. Would you explain to the Commissioner why that was?

A. Yes. In the first place that is customary in property settlements, in the settlement of marital difficulties in Delaware, and in the second place it is justified by law and Court decisions in Delaware. I assume you don't want me to tell you what the law is.

Commissioner Hogenson: That has been your experience in handling cases throughout your career, I take it?

The Witness: That has been my experience, sir, and I have been been in cases where the Court has so decided and I know the statutory provisions that are involved.

Commissioner Hogenson: They can be cited, Mr. Murdoch.

Mr. Murdoch: Those are the only questions I have of Mr. Marford at this time.

Cross-examination.

By Mr. Donahue:

Q. Mr. Marford, in this particular case did not the Court require the payment of your fee by Mr. Davis?

A. No.

Q. You mentioned two particular tax consequences, that is, in regard to the question of alimony and in regard to possible gain upon a gift. Are these the only two tax [fol. 166] situations which you considered in handling Mrs. Davis' affairs?

A. I considered also whether the payments that were to be made for the support of the son would be taxable to Mrs. Davis.

Q. Did you consider at any time the tax consequences of this transaction, what they would be to Mr. Davis?

A. No, only in a general way. I was in a negotiating situation and, naturally, I had to try and anticipate what the other side was thinking about, and in that way I tried to think ahead and evaluate in my own mind what was being sought by the other side.

Q. Would you say, though, that your only concern was the protection of your client's interest?

A. That is entirely correct. For instance, I could see

immediately on the first counterproposition where instead of a property settlement Mr. Davis wanted to pay alimony over a ten-year basis, that he was trying to set up a basis under Section 71 that would be applicable where he could deduct the payments and Mrs. Davis would have to pay, so there I could see exactly what was being sought on the other side and I tried to counter it.

Q. Now, when did Mrs. Davis first contact you to represent her, approximately?

A. Well, my notes indicate that it was the Thursday [fol. 167] prior to June 15, 1954.

Q. And you testified, I believe, that she stated at that time primary demands and certain alternatives.

A. Yes.

Q. Would you say what those were?

A. May I preface my answer by saying Mrs. Davis, demands were not formulated at the time of her first interview. My notes indicate that her demands were formulated in a conference with me which was held on July 12, 1954, and those were the demands that were first communicated to Mr. Young the following day, July 13th.

Mrs. Davis' propositions were given to me after we had talked them over and, of course, they were given to me for the purpose of communicating to the other side.

No. 1, she was to leave the home. They were living under the same roof at the time.

No. 2, she was to receive one-half the appraised value of the home and its furnishings.

No. 3, she was to keep her own car, that is, the car she was using, which was an Oldsmobile, or if Mr. Davis preferred she would take the Chevrolet. She left that up to him.

No. 4, Mrs. Davis to receive 1,500 shares of du Pont common stock unconditionally plus a sufficient annual amount to pay the interest on an insurance loan existing [fol. 168] at the Farmers' Bank in Wilmington.

No. 5, she to have the custody of the son, Steve, but would agree to reasonable visitation.

No. 6, Mr. Davis to pay $400 monthly plus tuition, school and camp for Steve.

Now, as one alternative which she authorized me to communicate and which I did communicate, in lieu of the 1,500 shares of du Pont stock unconditionally, she said that she would take—and I told Mr. Young that she would take—$1,000 a month for life and she would support Steve but he would have to pay for school and camp, and to that there must be added the periodic payment to cover the cost of the insurance loan.

As a second alternative authorized and communicated was $1,000 a month until his retirement from the du Pont Company and then in lieu of support she would take 1500 shares of du Pont stock outright, also with enough money to pay the interest on the insurance loan. That was the original offer and the two alternatives that were attached to it.

Q. What was Mr. Davis' reaction to the original offer and the alternatives?

A. Mr. Davis' reaction was in the form of a counter-offer communicated to me by his attorney, Mr. Young, on August 24th, as follows: —do you want it?

Q. Yes, please, if you will.

[fol. 169] A. First he offered to give the car to Mrs. Davis, or one of the cars.

Second, he would pay her $24,000 as the figure to represent one-half the note value of the home and contents.

Third, or (a) under 3, he would pay off a loan of $18,-587.99 on Dominion Insurance Company of Canada insurance policy with a face value of $5,000 but which carried an annual premium of $2,096.50, which she would then assume and pay as her property but he would pay the loan off.

(b) under 3, the two New England Insurance Company policies aggregating $20,000, of which he was the owner and benficiary, with an aggregate of $1,006.20 annual payments, he would assign to Mrs. Davis and she would assume the annual premium payment.

3, a Great Western Insurance policy and a Pan-American policy of $50,000 each he insisted upon keeping, and there was a loan against those policies at the Farmers' Bank in Wilmington in a sum in excess of $47,000.

4, during the first quarter of 1955 he would enter into an irrevocable trust—I think this must be an error in my

notes. My notes say during the first quarter of 1955—yes—at Equitable Trust Company, now the Bank of Delaware, for Steven, and he would pay $700 quarterly into [fol. 170] that irrevocable trust for a period of 40 quarters thereby creating a corpus of $28,000. At the age of 18, which would be February 28, 1964, the trust would be disbursed at the discretion of the trustee for the maintenance, support and education of Steven, and should Steven die prior to that date his contributions would cease and the balance of the corpus and accumulated income then on hand would be divided one-half to Mrs. Davis and one-half to him.

Should Steven die after his 18th birthday there would be the same provision.

Should Steven be living and receive a degree or undergraduate work, certified to receive the undistributed corpus forthwith.

Should Davis be forced to retire prior to 65 because of physical disability, his contributions to this trust would be $400 a quarter instead of $700 a quarter.

5, he offered by this counteroffer to pay to Mrs. Davis on a calendar quarterly basis on the first day of the third month, monthly payments but made quarterly, the way I have it, and is the way it was communicated to me, in two categories: 1, if she remained unmarried, secondly, if she were married, beginning with $1,500 or $6,000 a quarter in 1954 and then decreasing to $700 a month, or $2,800 a quarter in 1964 and to end in April 1964. No stock.

Then if he should be retired for physical disability there [fol. 171] were to be reductions on a sliding scale over the years of 45 per cent in the first period, declining to 30 per cent at the end.

6, that they were to sign and file a joint Federal income tax return for 1954 but not thereafter.

Custody and visitation rights with respect to Steven were agreed to, and, last, he agreed at that time that he would pay my reasonable fee, the amount of which was not discussed.

Q. Now, you mentioned, Mr. Marford, as the first condition the primary offer that Mrs. Davis leave home. Can you state the reasons behind this request, if you know?

A. Well, when Mrs. Davis first came to see me they were living under the same roof. Some time later she left and

went to live in a property that she had owned for some period of time in Wilmington.

I am quite sure that I told her at the time of our conference that in my opinion a separation agreement with her husband would not be valid if they were living under the same roof at the time, that the separation had to be an accomplished fact prior to the date of the separation agreement, so it was understood between us if we were to work out an agreement there would have to be a separation in fact, and there was somewhere along the line but I can't tell you when.

[fol. 172] Q. You stated Mrs. Davis first contacted you some time prior to June 15th. Can you state what took place at that initial meeting?

A. No, I made no notes of that. I know, however, we just discussed the situation generally.

Q. Well, would you describe what the situation in general was at that time?

A. There I get myself into a position, Mr. Donahue, where I think my professional duty would be to raise, myself, the question of privilege. While I don't hesitate to testify to facts and demands that were communicated to me and agreed to by my client for the purpose of being communicated to the other side, I don't feel that I am free to testify to facts given to me by my client which related to the subject of her marital rights with her husband and what grounds, if any, for divorce or other legal action there did or did not exist.

* * * * *

[fols. 173-176] By Mr. Donahue:

* * * * *

Q. Mr. Marford, you stated that at one of the early meetings Mr. Young contacted you with regard to the possibility of a reconciliation, that upon contacting Mrs. Davis you determined the reconciliation was not possible. What was your reason for such a determination in so informing Mr. Young?

A. I informed Mr. Young as to that as a result of being so informed by Mrs. Davis, with authority to communicate her answer to Mr. Young.

Q. What reasons did Mrs. Davis state, if any?

A. I don't remember. I have no recollection and I have no notes on that. If I had a recollection it would probably be privileged.

Q. Can you state whether your legal work for Mrs. Davis stemmed out of a disagreement between Mr. and Mrs. Davis?

A. Well, it stemmed out of marital unhappiness of two people who were married to one another, living under the same roof. I don't know about the word "disagreement."

* * * * *

[fol. 177] By Mr. Donahue:

Q. Mr. Marford, during your work for Mrs. Davis were you attempting to conserve Mr. Davis' property in any way?

A. No, indeed.

Q. Were you attempting to protect Mr. Davis' property in any way?

A. No. My only interest was in Mrs. Davis and obtaining for her a fair settlement, I thought. What she was satisfied with was a fair settlement.

Q. Did you during your employment for Mrs. Davis give her any advice at all with regard to the grounds for divorce, the divorce itself or the jurisdiction which it might be obtained?

A. Yes.

[fol. 178] Q. Can you estimate what amount or what percentage of your work involved those matters?

A. I would venture to say that that subject was not discussed over fifteen minutes in all of our many conferences in the period of these negotiations.

Q. Now, when Mrs. Davis first came to you was she interested in obtaining a divorce?

A. She did not so indicate to me.

Q. When did she first so indicate, if you can recall?

A. She never so indicated.

Q. When was it decided she was to obtain a divorce, if you know?

A. It was decided between counsel at or about the time that we had reached a gentlemen's agreement prior to the

drafting of the definitive agreement, that these parties should be divorced and what was the easiest way to handle it, and that just naturally fell into the picture as part of it, but so far as I presently know it was not one of the desires or demands of either party.

Q. Now, refer, if you will, please, Mr. Marford, to Plaintiffs' Exhibit No. 6 which purportedly is a bill for professional services. Would you state the work which you performed for Mrs. Davis which is encompassed in this bill, just in a general way, if you will, sir?

A. I wonder if the Commissioner would permit me to [fol. 179] answer it in this way: I first demanded a fee payable by Mr. Davis of $12,500, and up until the last minute I stood by that.

One day just before the formalizing of the agreement, the execution of it on November 4, 1954, Mr. Davis, with Mr. Young's permission, came to my office to see me and I talked with him, having gotten Mr. Young's permission first to do so. Mr. Davis had two requests: First, that I reduce my fee to $10,000, and, second, would I please split up that $10,000. In a manner I did split it up and I submitted my bill to him in the way he asked me to submit it, and so far as I am concerned I cannot possibly segregate my fee in those two categories and justify one in one amount as against another. I can only tell you what I did in the aggregate.

Q. Would you say, then, with reference particularly to Plaintiff's Exhibit Nos. 5 and 6, that one-half of your services was devoted to tax matters on behalf of Mrs. Davis?

A. It is very hard to say that one-half of my services in point of hours or time were devoted to tax matters. A tax situation was involved here throughout and underlay the whole relationship of the parties, his desire to minimize taxes, her desire to minimize her subsequent taxes.

I had to be aware of that every moment of the time. I had to be aware of it when he made this gift proposition, [fols. 180-181] which, by the way, involved Section 1015 of the 1954 Code mentioned in a letter. I wouldn't attempt except by a general opinion to evaluate it. However, I would say, taking the total bill the way it was segregated

at his request, appears to me to be entirely reasonable. I can't say any more than that.

Q. Mr. Marford, would you say that in most of the legal work which you performed for your clients that you must consider tax consequences of one sort or another?

A. In my experience there is hardly a legal problem that come across my desk that doesn't involve some matter of state and/or federal taxes.

Q. Just one other question. You mentioned that you had a great many conferences and much negotiation. Is the result of those conferences and that negotiation embodied in the settlement agreement?

A. Yes.

Mr. Donahue: I think that is all I have, Your Honor.

Commissioner Hogenson: Any other questions, Mr. Murdoch?

Mr. Murdoch: I have no further questions.

Commissioner Hogenson: I take it, then, you are through examining this witness and the witness may be excused.

Mr. Murdoch: Yes, sir.

(Witness excused.)

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[fol. 182] [File endorsement omitted]

Exhibit "B" to Stipulation of Facts—Filed May 19, 1959

This Agreement made this 4th day of November, A. D. 1954, between T. Crawley Davis (hereinafter sometimes called "husband") and Alice M. Davis (hereinafter sometimes called "wife") both of the County of New Castle and State of Delaware.

Witnesseth

Whereas, the parties hereto were married in due form of law on the first day of March, A. D. 1941, at Baltimore, Maryland, and thereafter lived and cohabited together as man and wife until November 3, 1954; and

Whereas, there is lawful issue of the marriage between

the parties, namely Stephen Alan Davis who was born Feberuary 28, 1946; and

Whereas, various disputes and differences have arisen between the husband and the wife, the said parties having separated are presently living separate and apart and intend so to continue to live apart from one another during the remainder of their respective lives; and

Whereas the parties hereto intend by this agreement to settle their respective rights and obligations against and to one another by (1) making a division of their property; (2) providing in lieu of alimony in the event of a decree of divorce for the support and maintenance of the wife; (3) making an arrangement and provision for the sup- [fol. 183] port and maintenance of Stephen; and (4) defining the rights of custody, maintenance, support and education of their minor child.

Now, Therefore, in consideration of the premises and of their mutual promises and undertakings herein contained, the parties mutually covenant and agree, each with the other, as follows:

1. The parties may and shall at all times hereafter live and continue to live separate and apart. Each shall be free from interference, authority and control, direct or indirect, by the other as fully as if he or she were single and unmarried. Each may reside at such place or places as he or she may select. Each may, for his or her support, use and benefit, conduct, carry on and engage in any business, profession or employment which to him or her may seem advisable.

2. The parties shall not molest or interfere with each other, nor shall either of them compel or attempt to compel the other to cohabit or dwell with him or her, by any means whatsoever.

3. The parties do hereby make the followeding division in settlement of their property:

a. The real property where the parties heretofore have made their home and lived together, located on the Kennett Pike near Centreville, New Castle County, State of Dela- [fol. 184] ware, together with all the furniture, furnishings and other personal property remaining thereon, shall be

and hereafter remain the sole and separate property of the husband, subject however to the following express terms and conditions:

(1) The husband shall pay to the wife the sum of Thirty Thousand Dollars ($30,000.00) contemporaneously with the execution of this egreement.

(2) The wife shall be entitled as her sole and separate property to the automobile and other items of furniture and furnishings listed in Exhibit A attached hereto and by this reference made part of this agreement.

b. On April 1, 1955 and on April 1, 1956, husband shall become obligated to assign, transfer, set over and deliver to the wife as her sole and separate property, a total of One Thousand (1,000) shares of the common, capital stock of E. I. duPont deNemours & Company, free of all liens [fol. 185] and encumbrances and shall cause the certificates representing said shares to be transferred to the wife's name at his own cost and expense (including the expense of Federal documentary stamps incident to the transfer of corporate stock) as follows:

500 shares on April 1, 1955
500 shares on April 1, 1956

c. On January 15, 1955, husband shall become obligated to deliver to wife as soon as practicable, but not later than February 28, 1955, as her sole and separate property, free and clear of any right of claim thereto or control thereof by the husband, and free and clear of all liens and encumbrances, the following policies of insurance on the life of the husband, in each of which she shall be or is presently named as owner-beneficiary:

Policy No. 296483 of Dominion Life Assurance Company in the principal sum of Fifty Thousand Dollars ($50,000.00) as a paid-up policy with no further premium payments hereafter due thereon.

Policy No. 1255587 of New England Mutual Life Insur- [fol. 186] ance Company in the principal sum of Ten Thousand Dollars ($10,000.00) with premiums fully paid thereon to September 20, 1955.

Policy No. 1253395 of New England Mutual Life Insurance Company in the principal sum of Ten Thousand

Dollars ($10,000.00) with premiums fully paid thereon to September 20, 1955.

4. The wife shall, upon the request of the husband, release and relinquish or otherwise assign and set over as husband may direct, any and all right or interest which she has or may have in and to any policy of insurance on the life of the husband not mentioned in paragraph 3c of this agreement.

5. The husband does hereby further covenant and agree to pay to his wife for her maintenance and support the sum of $2,500 on December 15, 1954, and in addition, the sum of Five Hundred Fifty Dollars ($550.00) each and every month, the first payment to begin on the first day of November, 1954, and similar such payments on the first of each and every month thereafter for a period of ten (10) years, the final payment to be made on the first day of October, A. D. 1964, at which time the husband's obligation for any further payment for the maintenance and support of the wife shall cease and terminate, which payments together with the payments provided for in paragraph 6 herein the wife hereby expressly covenants and agrees to accept in lieu of all claims against the husband [fol. 187] for maintenance and support, past, present and future.

6. The husband in addition does further covenant and agree to pay to his wife for her maintenance and support within ten (10) days after each payment of dividends by E. I. duPont deNemours & Company to the holders of its common stock a sum of money equivalent to the per share dividend declared and paid by E. I. duPont deNemours & Company to the holders of its common stock multiplied by the number of shares of such common stock, not exceeding one thousand (1,000) shares, which shall not have been transferred to wife's name as of the date of any such dividend payment, but which husband obligates himself thereafter so to do by this agreement; said payments to commence on and after January 10, 1955.

7. The wife accepts the division of property as herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever

had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise. The wife hereby releases and acquits the husband and his estate of and from any and all claims, liabilities and obligations whatsoever except only such as are specifically imposed upon the husband hereunder.

8. The husband obligates himself to enter into an irrevocable trust agreement during the month of January, 1955, [fol. 188] with Equitable Security Company, Wilmington, Delaware, as trustee in the form shown by Exhibit B attached to and by this reference made a part of this agreement, said proposed trust being intended to provide for the support, maintenance and education of the said Stephen Alan Davis. The husband shall pay into said trust to become part of the corpus or principal thereof forty quarter annual payments of Seven Hundred Dollars ($700.00) each, beginning with the quarter annual period commencing January 1, 1955. The parties hereto covenant and agree that the payments so made to the trust by the husband and the terms and conditions of said trust agreement with respect to disbursement and distribution of principal and income shall constitute and be deemed part of this separation agreement between husband and wife more fully to provide for the support, maintenance and education of their minor child. The husband undertakes and agrees to keep, maintain and keep in force at all times during the continuance of the trust one or more policies of insurance on his life in a principal amount not less than Ten Thousand Dollars ($10,000.00) with the trustee of said trust as beneficiary thereof and with any and all proceeds from such insurance payable into said trust as part of the corpus thereof and subject to its terms in like manner as the payments covenanted by the husband to be made thereto. At no time shall the proceeds of said insurance policy or policies be utilized to an extent which would cause aggregate pay- [fol. 189] ments into the trust estate to exceed the sum of Twenty-eight Thousand Dollars ($28,000.00).

9. The wife shall have the sole care, custody and parental control of Stephen Alan Davis, the minor child of the parties hereto, subject however to reasonable rights of visitation on the part of the husband. The wife undertakes and agrees to maintain and support said minor child in addition

to the provision made for him under the terms of the aforesaid trust.

10. The wife shall sign with the husband a joint federal income tax return for the taxable year 1954. Upon the signing of such joint income tax return for the taxable year 1954 the husband covenants and agrees to exonerate and save the wife harmless from any liability on her part for any federal income taxes payable by or assessed against husband and wife for the taxable year 1954.

11. Except as herein to the contrary provided, the parties shall and do hereby mutually remise, release, and forever discharge each other from any and all actions, suits, debts, claims, demands and obligations whatsoever, both in law and in equity, which either of them ever had, now has, or may hereafter have against the other upon or by reason of any matter, cause, or thing up to the date of the execution of this agreement, it being the intention of the parties that henceforth there shall be, as between them, only such rights and obligations as are specifically provided in this [fol. 190] agreement.

12. Each party shall, at the request and expense of the other party at any time and from time to time hereafter, execute and deliver to the other party any and all instruments and assurances that the other party may reasonably require for the purpose of giving full force and effect to the provisions of this agreement.

13. The parties hereto and each of them covenant that this agreement is and shall be a complete and final settlement of all claims of every nature and kind between them. Upon performance of husband's covenants and undertakings under this agreement, the wife hereby waives, releases and relinquishes unto the husband all rights that she might otherwise have to any of the property of the husband and to any claim for support or maintenance for herself and their minor child, and that she will not incur or contract any debt or obligation on the husband's credit and that she will keep the husband and his estate indemnified against and from all debts and liabilities to be contracted or incurred by her with all actions, proceedings, claims and demands, costs, damages and expenses whatsoever in respect to such liabilities or any of them.

14. Said parties mutually covenant and agree each with

the other that each may freely sell or otherwise dispose of his or her own property by gift, deed, will or otherwise, [fol. 191] without the incumbrance of any claim of right or interest by the other, that each be, and he and she respectively are, hereby barred from any and all rights and claims by way of dower, c-urtesy, inheritance, descent, distribution, or any rights that might otherwise inure to either in any property of the other, will execute, acknowledge and deliver such deeds, instruments of release or conveyance, assurances or other instruments of writing as may be necessary to effectuate the complete and absolute release and relinquishment of any right or interest of any kind or character and howsoever arising of either party in any property of any character now belonging to the other party, and in any property which said other party may hereafter acquire, and in order to enable such other party to sell, convey or otherwise dispose of his or her own real or personal property free from any apparent right or interest therein on the part of the other.

15. Nothing herein contained shall constitute any condonation or release of any right of action which either of the parties may have to obtain a divorce from the other; and in the event that a final decree of divorce shall be granted by any court, dissolving the bonds of matrimony between the parties, such decree shall in no way effect the obligations of either of the parties hereunder. In the event a decree of divorce shall be granted, the provisions of the agreement may, but need not be, incorporated into such [fol. 192] decree, subject to the approval of the court granting such divorce.

In Witness Whereof, the parties hereto after consultation with their respective counsel relative to the matters herein set forth and agreed upon and having been advised fully and fairly as to all the facts and circumstances therein set forth and the legal effect of the provisions thereof, have hereunto set their hands and seals the day and year aforesaid.

In the presence of: /s/ H. Albert Young. /s/ James R. Morford.

/s/ T. Crawley Davis, (Seal). /s/ Alice M. Davis, (Seal).

[fol. 193] EXHIBIT "A" TO AGREEMENT

*Chaise and matching chair in master bedroom
Bedroom suite in blue bedroom
Bedroom suite in Steve's room
One-half the table linens
One-half the flat silver
Silver service
Two chairs in hall
One table in guest bedroom
Dropleaf table on sun porch
Small side table on sun porch
Serving cart on sun porch
One fireplace screen in dining room
One set of Lenox China
Two radios
One phonograph
Two serpentine chests in dining room
Two fans
Two card tables and chairs
Two folding utility tables
Tables and benches on rear terrace
Two chairs on front terrace
Ash trays, pictures, misc. small figurines and china birds

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* These are replaced by matching chairs more suitable for a man's bedroom.

[fol. 194] IN THE UNITED STATES COURT OF CLAIMS

No. 516–58

THOMAS CRAWLEY DAVIS and GRACE ETHEL DAVIS

v.

THE UNITED STATES

Converse Murdoch for plaintiffs.

Peter J. Donahue, with whom was Assistant Attorney General Charles K. Rice, for defendant. James P. Garland and Lyle M. Turner were on the brief.

OPINION—March 1, 1961

LARAMORE, Judge, delivered the opinion of the court:

Plaintiff [1] sues to recover an alleged overpayment of taxes for the year 1955. The Commissioner of Internal Revenue proposed to assess a tax deficiency in the sum of $6,318.66 on the basis of disallowance of the deduction of $5,000 for legal fees, and on the basis of including in plaintiff's gross income a net long-term capital gain of $3,737.31, representing the difference between the tax basis to plaintiff of 500 shares of du Pont stock transferred to Alice M. Davis his former wife during 1955 and the fair market value of such shares as of the date of transfer to her. The cost basis of the 500 shares of stock transferred on March 21, 1955, was $74,775.37. This stock had a fair market value on that date of $82,250, or an increase in value over the cost basis of $7,474.63, one-half of which gain, or $3,737.31, was taken into account in the proposed deficiency assessment.

[fol. 195] On February 14, 1958, plaintiff paid to the Dis-

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[1] Grace Ethel Davis, co-plaintiff, is the present wife of Thomas Crawley Davis. A joint tax return was filed for the year 1955. For this reason she joins as plaintiff in this proceeding. Hereinafter, all references to taxpayer will refer to Thomas Crawley Davis alone.

trict Director the amount of $6,961.95, representing the asserted deficiency for 1955 in the amount of $6,318.66, plus interest of $643.29.

On April 8, 1958, plaintiffs filed their claim for refund of Federal income taxes paid for 1955 in the sum of $13,-642.29. This claim was based on the failure to include all of the $12,506 of legal fees paid by Mr. Davis to a Mr. Young and a Mr. Morford on January 27, 1955, for legal services. Plaintiffs asserted in their claim that $2,500 was on that date paid to each attorney, or a total of $5,000, for legal services in connection with various Federal tax matters arising out of negotiations and execution of a separation and property settlement agreement between Mr. Davis and Alice M. Davis, his former wife. Plaintiffs further asserted that, additional sums as legal fees, $5,006 to Mr. Young and $2,500 to Mr. Morford, were paid on January 27, 1955, for services in connection with the negotiations and execution of the same settlement agreement primarily incurred in connection with the protection of Mr. Davis' position as a stockholder, officer, and director of du Pont. This claim further asserted that the inclusion in income of the net long-term capital gain of $3,737.31 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955, was erroneous, because such transfer was pursuant to the same separation and property division agreement and did not result in any income or gain to the taxpayer.

By registered letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified plaintiffs of the disallowance in full of their claim for refund for the year 1955. This suit results.

Plaintiff contends in this suit that he is entitled to a deduction for two types of legal fees paid by him: First, legal fees paid for tax advice, and second, legal fees incurred in connection with the matter principally involving the protection of plaintiff's position as a stockholder, director and officer of the du Pont Company. His contention with respect to the taxable gain on the stock transferred will be discussed later.

Plaintiff points to section 212(3) of the Internal Revenue Code of 1954, which was applicable for the calendar year [fol. 196] 1955, in support of his contention that legal fees paid for tax advice in connection with the negotiations of

the property division and separation agreement are deductible.

Sec. 212(3) provides:

> Sec. 212. Expenses for Production of Income.
>
> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
>
> * * * * * * *
>
> (3) in connection with the determination, collection, or refund of any tax.

Plaintiff then points to the Treasury Regulations under the above-quoted statutory provision as supporting his contention.

Treasury Regulation § 1.212-1 reads as follows:

> § 1.212-1. Nontrade or nonbusiness expenses.—
>
> (1) Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of tax liability or in contesting his tax liability are deductible.

Section 212(3) plaintiff says applies for the reason that the evidence shows that both Thomas Crawley Davis and his former wife were constantly aware of Federal income and gift tax problems which would vitally affect both parties in the negotiation. Further, that a new income tax code had just previously been enacted which involved extensive revisions of the prior internal revenue laws, and that tax advice was sought from attorneys for both parties. Consequently, plaintiff contends that he is entitled to deduct the fees paid as services for "* * * tax counsel or ex-

penses paid or incurred in connection with the preparation of * * * tax returns * * *."

We have no doubt that Congress in enacting section 212, *supra,* meant to grant a deduction for legal fees in connec- [fol. 197] tion with a determination, collection, or refund of any tax. The question then is whether the fees paid by plaintiff come within the purview of the Act. In the light of the Treasury Regulations promulgated thereunder, we think the question can only be answered in the affirmative. The Regulation, section 1.212-1, quoted above, specifically provides that expenses paid or incurred for tax counsel "* * * in connection with any proceedings involved in determining the extent of tax liability * * * are deductible." Therefore, it seems clear that the statute and regulations are broad enough to cover the deduction asked for.

The facts here show that in negotiating the separation and property settlement agreement, both Mr. Young and Mr. Morford considered the Federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client, and this same concentration for the interests of his own client was practiced by each attorney in negotiating the overall aspects of the property settlement agreement.

Further, the facts show that the bills for attorneys' fees were separated into two categories—one for services regarding the separation agreement, and the other for services in regard to tax matters. In this connection there is no evidence indicating that such allocation was done in bad faith, and the cases are legion holding that absent such evidence, such allocation should be accepted. *Maine Steel, Inc.* v. *United States,* 174 F. Supp. 702, 716 (1959); *Anita M. Baldwin,* 10 B.T.A. 1198 (1928). *Cf. Joseph Frank,* 22 T.C. 945 (1954), aff'd per cur. 226 F. 2d 600 (1955); *Bryant Heater Co.* v. *Commissioner,* 231 F. 2d 938, (1956).

In view of the foregoing, it seems obvious that the fees paid by plaintiff for consultation and advice in tax matters arising in connection with the settlement agreement are properly deductible from gross income.

This is not to say, however, that the fees paid to his

former wife's attorney, Mr. Morford, are also deductible. In spite of the facts that Mr. Davis was legally liable for his wife's attorney's fees, the evidence conclusively shows that Mr. Morford worked exclusively for his client, Mrs. [fol. 198] Davis, and considered the problems from the standpoint of his client alone. Certainly then it cannot be said that Mr. Morford's advice was directed to plaintiff's tax problems, and in order to qualify for a deduction, we think the attorney's fees must be directly and only connected with the taxpayer's estate. Consequently, we hold that only the attorney's fees paid by plaintiff to his personal attorney, Mr. Young, for tax advice, are properly deductible from his 1955 gross income.

Next we turn to the question of whether the taxpayer is entitled to deduct the amount paid Messrs. Young and Morford, representing charges for legal services in connection with the negotiation of a property division and separation agreement.

In this connection plaintiff contends that the legal fees were paid in connection with the preservation of his position as a stockholder, director, and officer of the du Pont Company and that said fees are deductible under the provisions of section 212(1)(2) of the Internal Revenue Code of 1954, *supra*.

At the outset of the discussion respecting this issue, we point out that the taxpayer is not entitled to a deduction for personal, living or family expenses under section 262 of the Internal Revenue Code of 1954, *supra*, and Treasury Regulation § 1.262-1(b)(7).

Section 262 of the Internal Revenue Code of 1954, *supra*, reads as follows:

> Personal, Living, and Family Expenses
>
> Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living or family expenses.

Treasury Regulation section 1.262-1(b)(7) provides:

> Personal, Living, and Family Expenses.—(a) *In general.* In computing taxable income, no deduction shall be allowed, except as otherwise expressly pro-

vided in chapter 1 of the Internal Revenue Code of 1954, for personal, living and family expenses.

(b) Examples of personal, living, and family expenses. Personal, living, and family expenses are illustrated in the following examples:

* * * * * * *

[fol. 199] (7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either husband or the wife. * * *

Therefore, in order to bring himself under the section permitting the deduction, plaintiff must show that the legal expenses were incurred in matters directly related to his business or the management, conservation or maintenance of property held for the production of income. See *Port* v. *United States*, 143 Ct. Cl. 334.

Plaintiff cites the cases of *McMurtry* v. *United States*, 132 Ct. Cl. 418 (1955); *Baer* v. *Commissioner*, 196 F. 2d 646 (1952); *Bowers* v. *Commissioner*, 243 F. 2d 904 (1957); and *Fisher* v. *United States*, 157 F. Supp. 364 (1957).

Defendant in opposition cites the U.S. Supreme Court decision in the case of *Lykes* v. *United States*, 343 U.S. 118 (1951), wherein the Supreme Court reviewed the legislative history of section 23(a)(2) of the 1939 Code, the predecessor to section 212 of the 1954 Code, which showed that Congress intended to allow deduction for income-producing activities of a commercial nature only and did not intend to allow the deduction of any expense designed to aid taxpayer to retain their property. The Supreme Court in *Lykes* stated at page 125:

> Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. That argument would carry us too far. It would mean that the expense of defending almost any claim would be deductible by a taxpayer on the ground that such defense was made to help him keep clear of liens whatever income-producing property he might have.

Admittedly, some courts have departed from the philosophy of the *Lykes* decision. *Baer* v. *Commissioner, supra; McMurtry* v. *United States, supra; Bowers* v. *Commissioner, supra; Owens* v. *Commissioner,* 273 F. 2d 251 (1959); *Fisher* v. *United States, supra;* and *Patrick* v. *United States,* 186 F. Supp. 48 (1960). However, many courts have not followed the departure or have distinguished the case on factual grounds. *Lewis* v. *Commissioner,* 253 F. 2d 821 [fol. 200] (1958); *Tressler* v. *Commissioner,* 228 F. 2d 356 (1955); *Howard* v. *Commissioner,* 202 F. 2d 28 (1953); *Richardson* v. *Commissioner,* 234 F. 2d 248 (1956); *Smith's Estate* v. *Commissioner,* 208 F. 2d 349 (1953); *Donnelly* v. *Commissioner,* 16 T.C. 1196 (1951); *Estate of Walsh* v. *Commissioner,* 28 T.C. 1274 (1957); *Douglas* v. *Commissioner,* 33 T.C. 349 (1959).

Of course, the defendant contends the rule in the *Lykes* case as followed by the court in the case of *Lewis* v. *Commissioner, supra,* is correct. On the other hand, plaintiff is just as positive that the *McMurtry, Baer, etc.,* cases provide the correct rule.

However, we believe that it is not necessary here to choose which decision is correct in the premises. We believe the cases cited by plaintiff are factually distinguishable from the facts in the case at bar.

The *McMurtry* decision, *supra,* related to a situation wherein the plaintiff's position to some extent depended on the amount of his stockholdings in the company.

In the *Baer* case, *supra,* the taxpayer owned a controlling interest in a closely held corporation and to have acceded to his wife's demands would have resulted in not only loss of control of the company and loss of dividends, but no doubt would have resulted in loss of his salary as well, if other and adverse parties gained control.

In *Bowers* v. *Commissioner, supra,* and *Patrick* v. *United States, supra,* as well as *Fisher* v. *United States, supra,* practically the same situation as in *Baer, supra,* existed. It was necessary for *Bowers* to retain the stock in order to maintain his control, management and income.

In the present case by contrast, almost all the legal expenses were incurred by reason of the marital rift between Mr. and Mrs. Davis. As a consequence thereof, his attorney's fees were practically all incurred in an effort to hold

to a minimum the amount necessary to effect a property settlement. It naturally follows that the attorney's fees paid for Mrs. Davis' attorney were to gain a maximum amount in the property settlement agreement. Furthermore, we believe from the evidence that in any event plaintiff has failed to prove that retention of the stock was neces- [fol. 201] sary to maintain him as an officer and director of du Pont. As a matter of fact, at the time of Davis' election to the Board, his stockholdings were substantially less than those of any other person nominated by the management for election to the Board. Furthermore, during Mr. Davis' service as a director, every person nominated by the management of du Pont was elected by the stockholders as a director.

Therefore, we think the facts of this case more nearly come under the rule laid down by the court in the cases of *Lewis* v. *Commissioner, supra; Tressler* v. *Commissioner, supra; Howard* v. *Commissioner, supra; Richardson* v. *Commissioner, supra; Smith's Estate* v. *Commissioner, supra; Donnelly* v. *Commissioner, supra; Estate of Walsh* v. *Commissioner, supra; Douglas* v. *Commissioner, supra.*

The above cases all stand for the proposition that attorney's fees generally seek to conserve estates but are not necessarily the basis for a deduction under the Internal Revenue Code. Thus we believe the rule of the *Lewis* case, *supra*, is the correct one in these premises; *i.e.*, following the Supreme Court's decision in *Lykes* v. *United States, supra*, the Court held that the legal expenses were not deductible. The above reasoning was followed by this court in the case of *Port* v. *United States, supra.*

Thus we hold that the attorneys' fees paid to both lawyers constituted personal expenses which are nondeductible under section 262 of the 1954 Code, *supra.*

The next and final contention of the taxpayer is that the taxpayer did not realize taxable gain by virtue of the stock transfer to his former wife pursuant to the property settlement agreement, and consequently the inclusion in income of the net long-term capital gain was erroneous.

The facts respecting the above situation are these: Pursuant to the separation agreement the taxpayer, Davis, transferred 500 shares of du Pont stock to his former wife, Alice M. Davis, in 1954. The taxpayer's cost basis of the

stock was $74,775.37 and the fair market value at the time of transfer was $82,250. The difference was taxed as capital gain under section 1001 of the Internal Revenue Code of 1954, 26 U.S.C. § 1001 (1958 Ed.) which provides:

[fol. 202] Determination of Amount of and Recognition of Gain or Loss

> (a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.
>
> (b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Plaintiff contends that the transfer of the stock was not in satisfaction of Alice M. Davis' right to support and maintenance, but was a part of a division of property. Plaintiff argues that Mrs. Davis' rights to support and maintenance were satisfied by the payment of $550 per month and the payment of dividends on a maximum of 1,000 shares of du Pont stock. This is so, plaintiff says, because the division of property was contained in one paragraph of the separation agreement, whereas the payments in lieu of alimony were in another paragraph.

It is the defendant's contention that under the rule laid down in the case of *Commissioner* v. *Mesta*, 123 F. 2d 986 (1941), cert. denied 316 U.S. 695 (1942), and *Commissioner* v. *Halliwell*, 131 F. 2d 642 (1942), cert. denied 319 U.S. 741, the increment in value was clearly taxable gain.

Plaintiff then argues the incorrectness of the *Mesta* decision, *supra*, and concludes with the statement in his brief that "plaintiffs are not prepared to concede the correctness of the *Mesta* decision, but believe that since the rule of that case is not here applicable it is necessary to further consider the *Mesta* case." Plaintiff further contends that the *Mesta* decision is not applicable because that case involved a transfer of property in connection with a division of prop-

erty and not a transfer in satisfaction of the husband's (plaintiff Davis) obligation to support. To support this contention plaintiff cites the case of *Commissioner* v. *Marshman*, 279 F. 2d 27 (1960), cert. denied — U.S. —. [fol. 203] Thus the situation is this: The Court of Appeals in the Third Circuit in a case involving an almost identical proposition, in 1941 found that there was a taxable capital gain. The Supreme Court denied certiorari. In 1942 the Court of Appeals, Second Circuit, in a substantially same situation reversed the Tax Court and found against the taxpayer. *Commissioner* v. *Halliwell, supra.* The Supreme Court denied certiorari. The ruling in the *Mesta* case, was cited with approval and followed by the court in *Halliwell.* Then in 1960, after the Tax Court had followed the 1941 and 1942 decisions, the Court of Appeals for the Sixth Circuit in the *Marshman* case, *supra*, reversed the Tax Court and specifically rejected the rule of the two cases on the Second and Third Circuit. The *Marshman* situation also is almost identical with the facts in the instant case. On December 12, 1960, the Supreme Court denied certiorari in the *Marshman* case. The result is that we are faced with two precedents pointing in opposite directions and an attempt to distinguish the two is inpossible.

Since there is no clear ground for distinguishment between the rule of the *Mesta-Halliwell* cases and the *Marshman* case, it behooves us to decide which rule is the correct one in the premises. While admittedly it is a troublesome question, we are of the opinion that the facts of the instant case more nearly come under the reasoning and the rule of the *Marshman* case. We say this because the statute, section 1001(b), expressly states that the amount realized from the sale or other disposition of property shall be the sum of any money *received* plus the fair market value of the property *received.* We think as did the court in *Marshman, supra*, that the measurement of gain cannot be the fair market value of the property transferred. We also believe, as did the court in *Marshman*, that the measure of the value of the wife's right to maintenance and support was dependent upon so many uncertain factors that neither the taxpayer nor a revenue officer could do more than guess at it.

Furthermore, to say that the fair market value of the property received is the same as the fair market value of the property given up, is the use of a formula different from the well-established formula for determining fair [fol. 204] market value. Fair market value is the price at which property would change hands between a willing seller and a willing buyer, neither being under any compulsion to buy or sell. Again we agree with the court in the *Marshman* case that a transaction between a husband and a wife made under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule.

Under the evidence of this case, like *Marshman*, many demands were made, many concessions were made, and under these circumstances values are lost sight of. This is especially true under the circumstances of this case wherein the husband even became ill because of the tensions resulting from the marital troubles. So it is reasonable to say that in some measure the husband was willing to pay at least some amount in order to have the marriage terminated. In these circumstances, the value of what was given up is no criterion of the fair market value of the "property" received.

For the above reasons, we cannot agree with the ruling in the *Mesta* case that the fair market value of the release by a wife of her alimony and dower rights against her husband and his estate is properly determined by ascertaining and giving to it the fair market value of the property which she received from her husband.

If the "property" received by Davis had no fair market value or if none has been shown, it may be economic gain but it is not taxable gain by reason of the express provision of section 1001(b). *Champlin* v. *Commissioner*, 71 F. 2d 23, 29.

Therefore, we believe that T. C. Davis did not realize taxable gain by virtue of the 1955 transfer of stock pursuant to the property settlement agreement. Consequently, plaintiff is entitled to recover the amount paid pursuant to the inclusion of capital gain in his 1955 tax, in addition to the amount paid by reason of the inclusion of attorney's fees paid his attorney for tax advice.

The exact amount of recovery will be determined pursuant to Rule 38(c).

It is so ordered.

Durfee, *Judge*; Madden, *Judge*; Whitaker, *Judge*; and Jones, *Chief Judge*, concur.

[fol. 205] Findings of Fact

The court, having considered the evidence, the report of Trial Commissioner Roald A. Hogenson, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiffs are citizens of the United States and residents of the State of Delaware. At the end of the calendar year 1955, they were husband and wife.

2. Plaintiff, Thomas Crawley Davis, had been previously married to Alice M. Davis, such marriage having existed from March 1, 1941, to January 5, 1955. On the latter date, Alice M. Davis, hereinafter referred to as Mrs. Davis, was granted an absolute and final decree of divorce from Mr. Davis upon the stated ground of "extreme cruelty, mental in nature" by the Second Judicial District Court of the State of Nevada. The separation and property settlement agreement of the parties, hereinafter mentioned in these findings, was approved by the Nevada court and incorporated by reference in its decree which, by its terms, ordered and directed the parties to comply with and to execute the terms and conditions of the agreement. Both parties were represented at the proceedings by Nevada attorneys who had not participated in any way in the preparation and execution of the agreement. Mrs. Davis appeared in person at the trial, but Mr. Davis did not personally participate.

3. Since 1934, Mr. Davis has been associated with E. I. du Pont de Nemours & Company, hereinafter referred to as du Pont or the company, in various capacities as an employee, officer, director and stockholder. His employment record with du Pont from November 16, 1934, to the date of the trial of this case on April 30, 1959, was as follows:

11-16-34 to 11-30-41 Manager, Tax Division, Treasurer's Department

12-1-41 to 8-26-44 Assistant Comptroller, Treasurer's Department

8-27-44 to 5-19-46 Assistant Treasurer, Treasurer's Department

5-20-46 to 1-18-48 First Assistant Treasurer, Treasurer's Department
1-19-48 to 12-20-53 Treasurer of the company
12-21-53 to 4-30-59 Member, Board of Directors, Member, Executive Committee, Vice President
11-1-54 to 4-30-59 Member, Finance Committee

[fol. 206] 4. From 1902 to the present time, du Pont has had a policy and practice of granting bonuses to its officers and employees. Prior to 1943, such bonuses were awarded in the form of du Pont stock. Due to the impact of the Federal withholding tax on incomes, such bonus awards were paid entirely in cash from 1943 to 1946. Beginning in 1947, such bonuses were paid partly in du Pont stock and partly in cash.

One of the primary purposes of the company in awarding bonuses in the form of stock was to tie the bonus awardees to the company as stockholders and thus intensify their interest in the company's business. It was generally known that the company's top officials expected bonus awardees to retain their du Pont stock, the recognized exceptions being in cases of necessity to sell bonus stock to pay income taxes or to purchase a suitable home.

5. Prior to the annual meeting of the du Pont stockholders, the secretary of the company each year prepares an analysis of the holdings and dispositions of stock by executives of the company. The president, vice presidents, and directors are and were expected to explain any substantial disposition of their stock.

Proxy statements issued by du Pont to its stockholders prior to each annual meeting show the holdings of du Pont stock by those persons nominated by the du Pont management for election or reelection by the stockholders to the company's board of directors.

6. During November 1953, Mr. Davis was advised by the president and by the chairman of the board of du Pont that he was being considered for election as a director, vice president and member of the executive committee of the company. At that time Mr. Davis had 2,842 shares of du Pont common stock registered in his name.

Effective December 21, 1953, Mr. Davis was elected by the board of directors as a director, vice president, and member

of the executive committee of du Pont. As a director, Mr. Davis was subject to reelection by the stockholders at the succeeding annual meetings in April of each year. Mr. Davis has continued to hold such offices up to the present time. Since November 1, 1954, Mr. Davis has also been a member of the finance committee of the company.

[fol. 207] 7. The changes in the du Pont stock holdings of Mr. Davis from February 28, 1953, through 1958, were as follows:

| | Shares in | Shares out | Shares remaining |
|---|---|---|---|
| Feb. 28, 1953 | ... | ... | 2,302 |
| Mar. 5, 1953 | 421 | ... | 2,723 |
| July 27, 1953 | 319 | ... | 3,042 |
| Sept. 1, 1953 | ... | 200 | 2,842 |
| Mar. 4, 1954 | 574 | ... | 3,416 |
| Mar. 18, 1954 | ... | 100 | 3,316 |
| Apr. 27, 1954 | ... | 100 | 3,216 |
| Oct. 7, 1954 | ... | 100 | 3,112 |
| Nov. 22, 1954 | ... | 100 | 3,016 |
| Mar. 3, 1955 | 65 | ... | 3,081 |
| Mar. 21, 1955 | ... | 500 | 2,581 |
| Jan. 30, 1956 | ... | 7 | 2,574 |
| Feb. 29, 1956 | 44 | ... | 2,618 |
| Mar. 21, 1956 | ... | 100 | 2,518 |
| Mar. 27, 1956 | ... | 500 | 2,018 |
| Feb. 27, 1957 | 286 | ... | 2,304 |
| Oct. 15, 1957 | ... | 10 | 2,294 |
| Dec. 16, 1957 | ... | 6 | 2,288 |
| July 18, 1958 | ... | 16 | 2,272 |

The disposition of 200 shares on September 1, 1953, 500 shares on March 21, 1955, and 500 shares on March 27, 1956, were to Mrs. Davis, as hereinafter related in these findings. The evidence indicates that the other dispositions were in the main for the purpose of paying Federal income taxes, and meeting the cash payments required by the separation and property settlement agreement.

All of Mr. Davis' du Pont stock holdings were acquired by him through bonus awards by the company.

8. The income of Mr. Davis for the years 1949 through 1953 was as follows:

| | 1949 | 1950 | 1951 | 1952 | 1953 |
|---|---|---|---|---|---|
| Salary and bonus from du Pont | $86,117.43 | $114,405.08 | $147,767.14 | $169,612.22 | $204,998.66 |
| Dividends on du Pont stock | 3,931.30 | 7,653.65 | 6,360.70 | 7,405.65 | 9,082.75 |
| Other income, or capital gains or loss | (856.22) | 3,470.51 | 695.28 | ........ | ........ |
| Totals | 89,192.51 | 125,529.24 | 154,823.12 | 177,017.87 | 214,081.41 |

9. For the calendar years 1954 and 1955, Mr. Davis' adjusted gross income amounted to the respective sums of $264,984.69 and $317,865.16, of which the following represented payments from du Pont:

[fol. 208]

| | 1954 | 1955 |
|---|---|---|
| Salary | $ 87,437.48 | $ 90,600.00 |
| Dividends treated as salary | 4,090.00 | 3,592.75 |
| | 91,527.48 | 94,192.75 |
| Bonus | 152,705.97 | 208,016.27 |
| Director's fees | 550.00 | 500.00 |
| Dividends on du Pont stock | 13,239.02 | 15,036.00 |
| Totals | $258,022.47 | $317,745.02 |

10. Mr. Davis' net worth statement as of July 1, 1954, was as follows:

| | | | |
|---|---|---|---|
| Cash in bank—Wilmington Trust Co. | | | $ 28,073 |
| Shares of du Pont common stock: | | | |
| Registered in his name | 3,216 shares | | |
| Deduct: held by company as unearned bonus | 802 shares | | |
| Remainder (including 100 shares pledged to Farmers Bank) | 2,414 shares @ $134.25 | | 324,079 |
| Insurance policies having cash surrender value: | | | |
| Travelers Insurance Co. $10M policy | | | 5,000 |
| U.S. Veterans Administration $10M policy | | | 5,000 |
| Great Western Life Assurance Co. $50M policy | | | 21,717 |
| Pan American Life Assurance Co. $50M policy | | | 17,493 |
| Dominion Life Assurance Co. $50M policy | | | 16,407 |
| Home on Kennett Pike | | | 76,000 |
| Home furnishings | | | 15,000 |
| Automobiles (3) | | | 3,000 |
| | | | 511,769 |
| 1954 Federal income tax unpaid | | $82,079 | |
| Mortgage on home | | 18,000 | |
| Borrowing from Farmers Bank | | 63,761 | |
| | | | $163,840 |
| Net Worth—July 1, 1954 | | | 347,929 |

As of July 1, 1954, delivery of 802 of the 3,216 shares of du Pont stock registered in Mr. Davis' name had been deferred to later years. Under the du Pont bonus plan, the 802 shares were subject to forfeiture in the event that prior to actual delivery to him, Mr. Davis' services with du Pont were terminated other than through death or retirement pursuant to the company's program.

[fol. 209] All of the property of the parties involved in the property settlement negotiations was owned by Mr. Davis subject only to the marital rights of Mrs. Davis under the laws of the State of Delaware.

11. For a period of many years, Mr. and Mrs. Davis had had many disagreements of a personal nature, which finally led Mrs. Davis to seek a separation in June 1954. About the middle of the year 1953, Mrs. Davis requested Mr. Davis to transfer one-half of his property into her name, including 1,500 shares of du Pont stock, but she did not then request a divorce or separation. Mr. Davis rejected these property demands, but offered to make future transfers of du Pont stock to Mrs. Davis as long as his stock holdings did not fall below 3,000 shares. Mr. Davis advised Mrs. Davis that otherwise his position with du Pont would be seriously jeopardized by stock transfers. On September 1, 1953, Mr. Davis transferred 200 shares of du Pont stock to Mrs. Davis to allay her demands. By December 1953, their relations had become so strained that they could not converse without quarrelling and there was great unhappiness in their home. Mrs. Davis' demands for a property division became more insistent, and in February 1954 she refused to sign a joint Federal income tax return until her request for property had been met.

In the week preceding June 15, 1954, Mrs. Davis consulted an attorney, Mr. James R. Morford, concerning her marital troubles and about obtaining a property settlement. Mrs. Davis then advised Mr. Davis that she had retained Mr. Morford, and requested Mr. Davis to retain an attorney to negotitate a separation agreement. Mrs. Davis' primary purpose in seeking a separation was to terminate a marital relationship which, for personal reasons, had not been successful. Mr. Davis at first declined, and refused to discuss a separation agreement or property settlement, but thereafter in the summer of 1954 retained an attorney, Mr. H. Albert Young, to represent him. At Mr. Davis' request, Mr. Young requested Mr. Morford to make an effort to accomplish a reconciliation of the parties, but Mrs. Davis rejected the proposal after a conference with her attorney.

12. Mrs. Davis' initial proposal for a property settlement and separation agreement was made through the respective [fol. 210] attorneys to Mr. Davis on July 13, 1954. Mrs.

Davis proposed that she would move from the home of the parties, receive one-half of the appraised value of the home and furnishings, take one automobile, receive 1,500 shares of du Pont stock, a sufficient annual payment to pay the interest on an insurance loan, have custody of the minor child, and receive $400 per month for support of the child. As a first alternative, Mrs. Davis proposed that in lieu of the 1,500 shares of du Pont stock she would accept $1,000 per month for life with the understanding that she would support the child. As a second alternative, Mrs. Davis proposed that in lieu of immediate delivery of the du Pont stock, she would accept the $1,000 per month payment until Mr. Davis' retirement from du Pont, and then in lieu of any subsequent support payments, transfer of 1,500 shares of du Pont stock upon his retirement.

On August 24, 1954, Mr. Davis made a counterproposal through the respective attorneys to award one of the automobiles to Mrs. Davis, pay her $24,000 for one-half of the net value of the home and furnishings pay off the $18,587.99 loan on a $50,000 insurance policy and award Mrs. Davis this policy, on condition she pay future premiums, award Mrs. Davis two unencumbered insurance policies aggregating $20,000 on the condition she assume future premium payments, to create an irrevocable trust for the minor child and pay $700 per quarter for 40 quarters, or $28,000 in 10 years, into a trust estate to be disbursed by the trustee for the support and education of the minor child, and to pay $18,000 per annum for ten years in quarterly installments to Mrs. Davis for her support and maintenance, with no stock to be transferred. Mr. Davis later amended this proposal by increasing the proposed cash payment for the one half value of the house and furnishings from $24,000 to $30,000.

These proposals and counterproposals having been successively rejected, a conference was held between Mr. and Mrs. Davis and their respective attorneys, and the parties then accomplished and executed the formal property settlement and separation agreement, dated November 4, 1954, included in the Nevada decree of divorce, and hereinafter related in these findings.

[fol. 211] 13. The separation and property settlement agreement recited that various disputes and differences had arisen between the husband and wife, and that they had per-

manently separated. It was further recited that "the parties hereto intend by this agreement to settle their respective rights and obligations against and to one another by (1) making a division of their property; (2) providing in lieu of alimony in the event of a decree of divorce for the support and maintenance of the wife; (3) making an arrangement and provision for the support and maintenance of Stephen; and (4) defining the rights of custody, maintenance, support and education of their minor child."

The agreement then provided a "division in settlement of their property." Mr. Davis was awarded the home property and all furnishings and personal property thereon on condition that he pay Mrs. Davis $30,000 in cash and that Mrs. Davis have a certain automobile and certain listed items of furniture and furnishings. Mr. Davis agreed to make future transfers of a total of 1,000 shares of du Pont stock to Mrs. Davis, 500 shares on April 1, 1955, and 500 shares on April 1, 1956. Mr. Davis also agreed to deliver to his wife as owner-beneficiary, not later than February 28, 1955, the following life insurance policies, free of all liens and encumbrances: the fully paid-up Dominion Life Assurance Company policy for $50,000; and the two New England Mutual Life Assurance Company policies, each for $10,000 and each having premiums fully paid to September 20, 1955. Mrs. Davis agreed to relinquish all rights to any other insurance policy.

Mr. Davis agreed to pay to Mrs. Davis "for her maintenance and support" the sum of $2,500 on December 15, 1954, and $550 per month payable on the first day of each month for the ten-year period from November 1, 1954, to October 1, 1964. Mrs. Davis agreed that she would accept these payment- "in lieu of all claims against the husband for maintenance and support, past, present, and future."

Mr. Davis also agreed to pay to Mrs. Davis "for her maintenance and support" a sum of money equivalent to the per-share dividend thereafter declared on du Pont stock, multiplied by the number of shares which, by the agreement of the parties, was to be transferred to Mrs. Davis in the [fol. 212] future, but which number of shares remained untransferred at the effective date of the dividend payment.

Mrs. Davis agreed to accept "the division of property herein provided in full settlement and satisfaction of any

and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise."

The agreement recited that Mrs. Davis would have the custody of the minor child of the parties, subject to reasonable visitation by Mr. Davis, and also provided that Mr. Davis would create an irrevocable trust, by executing an instrument in the form of that attached to the agreement, to provide "for the support, maintenance and education" of the minor child, and pay $700 per quarter-year commencing January 1, 1955, for 40 quarters, or ten years, into the trust estate, to be expended by the trustee for the education and use and benefit of the minor child. The agreement also required Mr. Davis to provide a $10,000 life insurance policy for the protection of the trust estate.

Both parties agreed to execute instruments necessary to carry the agreement into effect, and Mrs. Davis agreed to sign a joint Federal income tax return for 1954.

The agreement provided for a mutual release of all other debts, claims, and obligations, and also that Mrs. Davis upon the performance of Mr. Davis' undertakings waived all claims which she might otherwise have to any of the property of Mr. Davis and to any claim for support or maintenance of herself or the minor child.

The agreement further provided that in the event a decree of divorce should be granted, dissolving the marriage, the provisions of the agreement might, but need not be, incorporated into such decree, subject to the approval of the court granting such divorce.

14. Throughout the negotiations for the separation and property settlement agreement, and in property discussions prior thereto, Mr. Davis reasonably and honestly believed that immediate transfer to Mrs. Davis of 1,500 shares of du Pont stock would seriously jeopardize his chances of [fol. 213] election and reelection as a member of the du Pont board of directors, as a member of its executive committee and as a vice president of the company. He consistently related this belief to Mrs. Davis and to their respective attorneys, and resisted transfer of any stock until and in conformity with the settlement and separation agreement of

November 4, 1954. Mr. Davis believed that his associates in the top management of du Pont would understand and accept the necessity of transfer of stock in connection with the property settlement and separation agreement, but thought that it would not be acceptable to the stockholders in their election of the directors at their annual meetings.

At the time of his election to the board of directors of du Pont, Mr. Davis' stock holdings in the company were substantially less than those of any other person nominated by the management for election to the board. In subsequent years, only two directors, both of whom were recognized scientists, held fewer du Pont shares than Mr. Davis. Mr. Davis continued to be renominated by the management and reelected by the stockholders as a member of the board despite the transfers of his shares, as shown in finding 7. During Mr. Davis' service as a director, every person nominated by the management of du Pont was elected by the stockholders as a director.

15. Neither Mr. Young as attorney for Mr. Davis, nor Mr. Morford as attorney for Mrs. Davis, acted for either party in connection with the suit for divorce in Nevada, except that Mr. Young by telephone engaged a Nevada law firm which independently handled the proceedings.

16. The matter of obtaining a decree of divorce or decree of legal separation was not proposed by either Mr. Davis or Mrs. Davis until November 1954. The marital difficulties had caused Mr. Davis such great discomfort and emotional upset that it had been necessary for him to be hospitalized. Mr. Davis concluded and advised Mrs. Davis that from his standpoint a divorce should be obtained. Thereafter discussions were carried on between Mrs. Davis, Mr. Morford, and Mr. Young about divorce proceedings, and the Nevada divorce suit was thereafter prosecuted by Nevada attorneys.

17. In negotiating the separation and property settlement agreement, both Mr. Young and Mr. Morford considered [fol. 214] the federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client, and this same concentration for the interests of his own client was practiced by each attorney in negotiating the overall aspects of the property settlement agreement.

18. Both Mr. Young and Mr. Morford had had many years

of experience as successful practicing lawyers in the State of Delaware. In the negotiations involved in this case, they advised Mr. Davis that it was the practice in conformity with Delaware law that the husband pay the attorneys' fees of both parties in connection with negotiations for a separation and property settlement agreement. As a result of this advice, Mr. Davis understood that he had to pay the fees of Mrs. Davis' attorney, and agreed to do so.

19. The separation and property settlement agreement contained no provisions concerning payment of attorneys' fees. However, in accordance with the oral understanding, Mr. Davis paid to his own attorney, Mr. Young, total fees in the sum of \$12,506, and total fees to Mrs. Davis' attorney, Mr. Morford, in the sum of \$10,000.

On November 17, 1954, Mr. Young provided Mr. Davis with two separate bills, one for \$7,506, for his services "Re: Separation Agreement and Property Division between T. C. Davis and Alice M. Davis," and the other for \$5,000 for his services "Re: Tax matters in the case of Davis v. Davis." Each of these bills showed that Mr. Davis had made a payment of \$2,500 on each of them on November 16, 1954, leaving respective balances of \$5,006 and \$2,500.

On December 16, 1954, Mr. Morford provided Mr. Davis with two separate bills, one for \$5,000 "To professional services in the matter of division of property and the preparation of separation agreement between T. Crawley Davis and Alice M. Davis," and the other for \$5,000 "To professional services rendered in connection with tax matters involved in the matter of Alice M. Davis versus T. Crawley Davis." Each of these bills showed that Mr. Davis had made a payment of \$2,500 on each of them on November 14, 1954, leaving a balance on each bill of \$2,500.

[fol. 215] On January 27, 1955, Mr. Davis paid his attorney, Mr. Young, the sums of \$5,006 and \$2,500, being the balances on the two bills submitted to him by Mr. Young.

On January 27, 1955, Mr. Davis made two payments to Mrs. Davis' attorney, Mr. Morford, of \$2,500 each, being the respective balances on the two bills submitted to him by Mr. Morford.

Mr. Morford testified in this case that he split his overall fee into two categories at the request of Mr. Davis, and that he could not possibly segregate his fee in such manner and justify the amount of one bill as against the other. He later

testified that tax problems underlaid the whole relationship of the parties and that his general opinion was that the segregation of the total fee, as it was done at the request of Mr. Davis, appeared to him to be entirely reasonable. In his appearance as a witness in this case. Mr. Young's testimony was vague and general as to the reasonableness and propriety of the division of his overall fee into the two categories, and he did not state whether the segregation was made by him independently or at the suggestion of Mr. Davis.

20. There is no testimony or evidence in this case from which it can be determined the extent to which the attorneys' fees paid by Mr. Davis either to Mr. Young or to Mr. Morford were reasonably allocable to the effort of Mr. Davis to retain his shares of du Pont stock and thereby to preserve his position and earning capacity with the du Pont company.

21. On March 21, 1955, Mr. Davis transferred to Mrs. Davis 500 shares of du Pont common stock pursuant to the terms of the property settlement agreement.

22. On or before April 15, 1956, plaintiffs filed their joint Federal income tax return for the calendar year 1955 with the District Director of Internal Revenue for Delaware. Such return showed taxable income of $276,374.43 and net tax payable of $202,014.52. The latter amount was duly paid on or before April 15, 1956.

In this 1955 return, plaintiffs claimed as a deduction legal fees in the amount of $5,000. These legal fees were the two payments of $2,500 each, one made to Mr. Young and the [fol. 216] other to Mr. Morford, as related in finding 19, covering the respective unpaid balances on the bills of the attorneys for tax services in connection with the separation and property settlement agreement. The plaintiffs did not include as deductions the other legal fees of $5,006 paid to Mr. Young, and $2,500 paid to Mr. Morford, on January 27, 1955.

23. In connection with the audit of plaintiffs' income tax return for 1955, the agent of the Internal Revenue Service proposed to assess a tax deficiency in the sum of $6,318.66 on the basis of disallowance of the deduction of $5,000 for legal fees and on the basis of including in plaintiffs' gross income a net long-term capital gain of $3,737.21, representing the difference between the tax basis to Mr. Davis of the 500 shares of du Pont stock transferred to Alice M. Davis

during 1955 and the fair market value of such shares as of the date of the transfer to her.

Mr. Davis had a cost basis of $74,775.37 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955. This stock had a fair market value on that date of $82,250, or an increase in value over the cost basis of $7,474.63, one-half of which gain, or $3,737.31, was taken into account in the proposed deficiency assessment.

24. On February 14, 1958, Mr. Davis paid to the District Director the amount of $6,961.95, representing the asserted deficiency for 1955 in the amount of $6,318.66 plus interest of $643.29.

25. On April 8, 1958, plaintiffs filed their claim for refund of Federal income taxes paid for 1955 in the sum of $13,642.29. This claim was based on the failure to include all of the $12,506 of legal fees paid by Mr. Davis to Mr. Young and Mr. Morford on January 27, 1955, as related in finding 19. Plaintiffs asserted in their claim that $2,500 was on that date paid to each attorney, or a total of $5,000, for legal services in connection with various Federal tax matters arising out of negotiations and execution of the separation and property settlement agreement. Plaintiffs further asserted that additional sums as legal fees, $5,006 to Mr. Young and $2,500 to Mr. Morford, were paid on January 27, 1955, for services in connection with the negotiations and execution of the same agreement, primarily [fol. 217] incurred in connection with the protection of Mr. Davis' position as a stockholder, officer, and director of du Pont.

This claim further asserted that the inclusion in income of the net long-term capital gain of $3,737.31 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955, was erroneous, because such transfer was pursuant to the same separation and property division agreement and did not result in any income or gain to the taxpayer.

26. By registered letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified plaintiffs of the disallowance in full of their claim for refund for the year 1955.

## Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment will be entered to that effect.

The amount of recovery will be determined pursuant to rule 38(c) of the rules of this court.

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[fol. 218] IN THE UNITED STATES COURT OF CLAIMS

No. 516-58

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS,

v.

THE UNITED STATES

## ORDER ENTERING JUDGMENT—April 14, 1961

On March 1, 1961, the court rendered an opinion together with findings of fact, holding that the plaintiffs were entitled to recover and entering judgment to that effect. The determination of the amount of recovery was reserved pending further proceedings pursuant to Rule 38(c).

On April 6, 1961, the commissioner of this court filed a memorandum report recommending that, in accordance with the opinion of the court, judgment be entered for the plaintiffs in the sum of $4,510.45, together with interest thereon from February 14, 1958, as provided by law.

Now, Therefore, It Is Ordered this fourteenth day of April, 1961, that judgment be and the same is entered for the plaintiffs in the sum of four thousand five hundred ten dollars and forty-five cents ($4,510.45), together with interest thereon from February 14, 1958, as provided by law.

By the Court:

/s/ Samuel E. Whitaker, Acting Chief Judge

[fol. 219] Clerk's Certificate to foregoing transcript omitted in printing.

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[fol. 220] Clerk's Certificate to foregoing transcript omitted in printing.

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[fol. 221] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1960

No.

UNITED STATES, Petitioner,

v.

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—May 23, 1961

Upon Consideration of the application of counsel for petitioner(s),

It Is Ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including June 29th, 1961.

Earl Warren, Chief Justice of the United States.

Dated this 23rd day of May, 1961.

[fol. 222] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1960

No.

THOMAS CRAWLEY DAVIS, et al., Petitioners,

v.

THE UNITED STATES

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—June 1, 1961

Upon Consideration of the application of counsel for petitioner(s),

It Is Ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 29th, 1961.

Earl Warren, Chief Justice of the United States.

Dated this 1st day of June, 1961.

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[fol. 223] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1961

No. 190

UNITED STATES, Petitioner,

vs.

THOMAS CRAWLEY DAVIS, et al.

ORDER ALLOWING CERTIORARI—October 9, 1961

The petition herein for a writ of certiorari to the United States Court of Claims is granted. The case is consolidated with No. 268 and a total of two hours is allowed for oral argument.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 224] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1961

No. 268

THOMAS CRAWLEY DAVIS, et al., Petitioners,

vs.

THE UNITED STATES

ORDER ALLOWING CERTIORARI—October 9, 1961

The petition herein for a writ of certiorari to the United States Court of Claims is granted. The case is consolidated with No. 190 and a total of two hours is allowed for oral argument.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1961 619226 386

FILE COPY



No. 190

# In the Supreme Court of the United States

OCTOBER TERM, 1961

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UNITED STATES, PETITIONER

v.

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS

---

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

---

ARCHIBALD COX,
*Solicitor General,*
LOUIS F. OBERDORFER,
*Assistant Attorney General,*
I. HENRY KUTZ,
SHARON L. KING,
*Attorneys,*
*Department of Justice, Washington 25, D.C.*

# INDEX



## CITATIONS





599594—61——1

# In the Supreme Court of the United States

OCTOBER TERM, 1961

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No. —

UNITED STATES, PETITIONER

*v.*

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS

---

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS**

---

The Solicitor General, on behalf of the United States, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Claims in this case.

## OPINION BELOW

The opinion of the Court of Claims (Appendix, *infra*, pp. 8–31) is reported at 287 F. 2d 168.

## JURISDICTION

The judgment was entered on March 1, 1961. (Appendix, *infra*, p. 8.) By order of the Chief Justice, dated May 23, 1961, the time for filing a petition for a writ of certiorari was extended to and including June 29, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1255.

## QUESTION PRESENTED

Whether a husband realizes taxable gain when he transfers to his divorced wife, in return for the re-

lease of her marital claims, assets which have appreciated in value during his ownership.

## STATUTE INVOLVED

Internal Revenue Code of 1954:

SEC. 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. * * *

(26 U.S.C. 1001.)

## STATEMENT

The material facts, as found by the Court of Claims (Appendix, *infra,* pp. 19–31), may be summarized as follows:

On November 4, 1954, Thomas Crawley Davis ("the taxpayer") and his former wife, Alice M. Davis,[1] executed a formal property settlement and separation agreement. The agreement was negotiated by lawyers for the two principals after extended bargaining. The taxpayer agreed, *inter alia,* to transfer to Alice

[1] Respondent Grace Ethel Davis is taxpayer's present wife. She is a party to this proceeding because she and her husband filed a joint tax return in 1955.

M. Davis 1,000 shares of duPont stock, 500 shares to be delivered by April 1, 1955, and 500 shares by April 1, 1956. (Appendix, *infra*, pp. 23–25.) Mrs. Davis, on her part, agreed to accept (Appendix, *infra*, (p. 26):

> * * * "the division of property herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise."

All of the property involved in the settlement negotiations was owned by Mr. Davis subject only to the marital rights of Mrs. Davis under Delaware law. (Appendix, *infra*, p. 23.)

On January 5, 1955, Alice M. Davis was granted a final decree of divorce from Mr. Davis by the Second Judicial District Court of the State of Nevada. The court's decree approved the settlement agreement of the parties and directed them to carry it out. (Appendix, *infra*, p. 19.)

On March 21, 1955, taxpayer, pursuant to the agreement, transferred to Mrs. Davis 500 shares of duPont common stock. His cost basis in these shares was $74,775.37 and their fair market value at the time of the transfer was $82,250. (Appendix, *infra*, pp. 29, 30.) The Commissioner determined an income tax deficiency for 1955 on the ground that Mr. Davis realized a taxable gain of $7,474.63, the difference between the two figures. Overruling the Commissioner's

determination, the Court of Claims held that, although the taxpayer may have realized economic gain, he did not realize taxable gain under the provisions of Section 1001(a) of the 1954 Code (*supra*, p. 2) (Appendix, *infra*, p. 18). The Court reasoned that the statutory definition of "amount realized" calls for a determination of "fair market value of the property * * * received" and that there were no adequate criteria for measuring the value of the marital rights released by Alice M. Davis.

**REASONS FOR GRANTING THE WRIT**

1. The decision of the Court of Claims expressly rejects the rule adopted by the Third Circuit in *Commissioner* v. *Mesta,* 123 F. 2d 986, certiorari denied, 316 U.S. 695, and the Second Circuit in *Commissioner* v. *Halliwell,* 131 F. 2d 642, certiorari denied, 319 U.S. 741.[2] On their facts, both cases are indistinguishable from the case at bar. In each, precisely as in this

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[2] The decision below follows the Sixth Circuit's decision in *Marshman* v. *Commissioner*, 279 F. 2d 27, which also held that a husband realized no taxable gain by transfer of appreciated securities to his divorced wife in exchange for her release of marital rights. In *Marshman*, the wife petitioned for certiorari since the holding that the husband realized no gain might result in the conclusion that she received the securities at the husband's original cost basis, rather than on the basis of fair market value at the time of transfer. The government did not oppose the petition but noted that the case might be deemed an inappropriate vehicle for resolving the conflict inasmuch as there was an alternative ground of decision in the case. See Memorandum for the Respondent in No. 366, October Term, 1960. The Commissioner also filed a protective cross-petition against the husband's estate. Both petitions were denied. 364 U.S. 918.

The *Marshman* decision has been criticized in 61 Col. L. Rev. 101; 74 Harv. L. Rev. 1226; and 109 U. of Pa. L. Rev. 438.

case, a husband transferred appreciated stock to his wife pursuant to a property settlement. In each, the wife, in return, released all claims to maintenance and support and all rights to share in the husband's estate. The Second and Third Circuits have held that the respective husbands realized taxable gain in the amount of the difference between the cost of the stock to the husband and its fair market value at the time of the transfer. In their view, the worth of the property received—the release of the wife's alimony and dower rights—may be properly determined by reference to the value of the property given. In other words, it may fairly be presumed that one who exchanges property of known value for an unliquidated claim receives his money's worth.[3]

The *Mesta-Halliwell* principle has been applied in other contexts. There are, of course, numerous situations in which "A" may exchange appreciated property in return for "B's" release of unliquidated claims, inchoate rights or other species of property not readily susceptible of appraisal. It would be anomalous indeed if the difficulty of making an independent valuation of "B's" property should relieve "A" of the necessity of paying a capital gains tax on the measurable appreciation which his property enjoyed. See, *e.g., International Freighting Corp.* v. *Commissioner,* 135 F. 2d 310 (C.A. 2d) (appreciated property used to pay unliquidated bonus awards to

[3] It may be added that a taxpayer, in a refund suit, has the burden of establishing that the Commissioner's determination was invalid. *Helvering* v. *Taylor*, 293 U.S. 507; *Commissioner* v. *Mesta*, *supra*.

employees); *United States* v. *General Shoe Corp.*, 282 F. 2d 9 (C.A. 6th), certiorari denied, 365 U.S. 843 (conveyance of appreciated property by corporation to employees' retirement trust).[4] The rationale of the decision below cannot be reconciled with these cases.

2. It is apparent that husband-wife property settlements incident to separation or divorce are events of common occurrence and that assets which appreciated during the husband's holding period are frequently involved in the settlement. It is accordingly important to the revenue that there be a uniform rule of law for purposes of determining whether the husband realizes taxable gain when he transfers such property to the wife. The transfer, we emphasize, marks "the last step * * * by which he obtains the fruition of the economic gain which has already accrued to him," *Helvering* v. *Horst,* 311 U.S. 112, 115.

There is a further dimension to the problem created by the decision below. Suppose that the wife subsequently sells the property which she received under the marital settlement. It has been held that her basis is the fair value of the property as of the time she acquired it in exchange for the relinquishment of her marital rights. *Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812 (C.A. 2d); *Commissioner* v. *Patino,* 186 F. 2d 962 (C.A. 4th). If this is so, the view adopted by the Court of Claims would lead to

[4] As indicated by a comparison of the *General Shoe* and *Marshman* cases, the Sixth Circuit has followed the *Mesta-Halliwell* approach in nonmarital cases. In our view, there is no sound basis of distinction from the standpoint of measuring the taxable gain.

the result that the taxpayer-husband avoids taxation on the appreciation which took place during his holding period while his taxpayer wife nonetheless obtains a "stepped-up" basis. Taxation of the gain is thus not merely deferred; it is eliminated.

Finally, there can be no assurance that the rationale of the decision below will not be applied to transactions other than husband-wife marital settlements, *i.e.*, to other transactions in which there is no adequate independent means of appraising the value of rights released in exchange for appreciated property.

## CONCLUSION

There is a direct conflict of decisions which requires resolution by this Court. The issue is one which has importance to the revenue and affects innumerable taxpayers. This petition should accordingly be granted.

Respectfully submitted.

ARCHIBALD COX,
*Solicitor General.*
LOUIS F. OBERDORFER,
*Assistant Attorney General.*
I. HENRY KUTZ,
SHARON L. KING,
*Attorneys.*

JUNE 1961.

599594—61——2

## APPENDIX

# In the United States Court of Claims

No. 516–58

(Decided March 1, 1961)

---

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS v. THE UNITED STATES

---

Converse Murdoch for plaintiffs.

*Peter J. Donahue*, with whom was *Assistant Attorney General Charles K. Rice*, for defendant. *James P. Garland* and *Lyle M. Turner* were on the brief.

OPINION

LARAMORE, *Judge*, delivered the opinion of the court:

Plaintiff [1] sues to recover an alleged overpayment of taxes for the year 1955. The Commissioner of Internal Revenue proposed to assess a tax deficiency in the sum of $6,318.66 on the basis of disallowance of the deduction of $5,000 for legal fees, and on the basis of including in plaintiff's gross income a net long-term capital gain of $3,737.31, representing the difference between the tax basis to plaintiff of 500 shares of du Pont stock transferred to Alice M. Davis, his former wife, during 1955 and the fair market value of such shares as of the date of transfer to her. The cost basis of the 500 shares of stock transferred on March 21, 1955, was $74,775.37. This stock had a fair market value on that date of $82,250, or an increase in value over the cost basis of $7,474.63, one-half of which gain, or $3,737.31, was taken into account in the proposed deficiency assessment.

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[1] Grace Ethel Davis, co-plaintiff, is the present wife of Thomas Crawley Davis. A joint tax return was filed for the year 1955. For this reason she joins as plaintiff in this proceeding. Hereinafter, all references to taxpayer will refer to Thomas Crawley Davis alone.

On February 14, 1958, plaintiff paid to the District Director the amount of $6,961.95, representing the asserted deficiency for 1955 in the amount of $6,318.66, plus interest of $643.29.

On April 8, 1958, plaintiffs filed their claim for refund of Federal income taxes paid for 1955 in the sum of $13,642.29. This claim was based on the failure to include all of the $12,506 of legal fees paid by Mr. Davis to a Mr. Young and a Mr. Morford on January 27, 1955, for legal services. Plaintiffs asserted in their claim that $2,500 was on that date paid to each attorney, or a total of $5,000, for legal services in connection with various Federal tax matters arising out of negotiations and execution of a separation and property settlement agreement between Mr. Davis and Alice M. Davis, his former wife. Plaintiffs further asserted that additional sums as legal fees, $5,006 to Mr. Young and $2,500 to Mr. Morford, were paid on January 27, 1955, for services in connection with the negotiations and execution of the same settlement agreement primarily incurred in connection with the protection of Mr. Davis' position as a stockholder, officer, and director of du Pont. This claim further asserted that the inclusion in income of the net long-term capital gain of $3,737.31 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955, was erroneous, because such transfer was pursuant to the same separation and property division agreement and did not result in any income or gain to the taxpayer.

By registered letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified plaintiffs of the disallowance in full of their claim for refund for the year 1955. This suit results.

Plaintiff contends in this suit that he is entitled to a deduction for two types of legal fees paid by him: First, legal fees paid for tax advice, and second, legal fees incurred in connection with the matter principally involving the protection of plaintiff's position as a stockholder, director, and officer of the du Pont Company. His contention with respect to the taxable gain on the stock transferred will be discussed later.

Plaintiff points to section 212(3) of the Internal Revenue Code of 1954, which was applicable for the calendar year

1955, in support of his contention that legal fees paid for tax advice in connection with the negotiations of the property division and separation agreement are deductible.

Section 212(3) provides:

> Sec. 212. EXPENSES FOR PRODUCTION OF INCOME.
>
> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
>
> * * * * *
>
> (3) in connection with the determination, collection, or refund of any tax.

Plaintiff then points to the Treasury Regulations under the above-quoted statutory provision as supporting his contention.

Treasury Regulation § 1.212–1 reads as follows:

> § 1.212–1. Nontrade or nonbusiness expenses.—
>
> (1) Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of tax liability or in contesting his tax liability are deductible.

Section 212(3) plaintiff says applies for the reason that the evidence shows that both Thomas Crawley Davis and his former wife were constantly aware of Federal income and gift tax problems which would vitally affect both parties in the negotiation. Further, that a new income tax code had just previously been enacted which involved extensive revisions of the prior internal revenue laws, and that tax advice was sought from attorneys for both parties. Consequently, plaintiff contends that he is entitled to deduct the fees paid as services for "* * * tax counsel or expenses paid or incurred in connection with the preparation of * * * tax returns * * *."

We have no doubt that Congress in enacting section 212, *supra*, meant to grant a deduction for legal fees in connection

with a determination, collection, or refund of any tax. The question then is whether the fees paid by plaintiff come within the purview of the Act. In the light of the Treasury Regulations promulgated thereunder, we think the question can only be answered in the affirmative. The Regulation, section 1.212–1, quoted above, specifically provides that expenses paid or incurred for tax counsel "* * * in connection with any proceedings involved in determining the extent of tax liability * * * are deductible." Therefore, it seems clear that the statute and regulations are broad enough to cover the deduction asked for.

The facts here show that in negotiating the separation and property settlement agreement, both Mr. Young and Mr. Morford considered the Federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client, and this same concentration for the interests of his own client was practiced by each attorney in negotiating the overall aspects of the property settlement agreement.

Further, the facts show that the bills for attorneys' fees were separated into two categories—one for services regarding the separation agreement, and the other for services in regard to tax matters. In this connection there is no evidence indicating that such allocation was done in bad faith, and the cases are legion holding that absent such evidence, such allocation should be accepted. *Maine Steel, Inc.* v. *United States*, 174 F. Supp. 702, 716 (1959); *Anita M. Baldwin*, 10 B.T.A. 1198 (1928). Cf. *Joseph Frank*, 22 T.C. 945 (1954), aff'd per cur. 226 F. 2d 600. (1955); *Bryant Heater Co.* v. *Commissioner*, 231 F. 2d 938, (1956).

In view of the foregoing, it seems obvious that the fees paid by plaintiff for consultation and advice in tax matters arising in connection with the settlement agreement are properly deductible from gross income.

This is not to say, however, that the fees paid to his former wife's attorney, Mr. Morford, are also deductible. In spite of the fact that Mr. Davis was legally liable for his wife's attorney's fees, the evidence conclusively shows that Mr. Morford worked exclusively for his client, Mrs. Davis, and

considered the problems from the standpoint of his client alone. Certainly then it cannot be said that Mr. Morford's advice was directed to plaintiff's tax problems, and in order to qualify for a deduction, we think the attorneys' fees must be directly and only connected with the taxpayer's estate. Consequently, we hold that only the attorney's fees paid by plaintiff to his personal attorney, Mr. Young, for tax advice, are properly deductible from his 1955 gross income.

Next we turn to the question of whether the taxpayer is entitled to deduct the amount paid Messrs. Young and Morford, representing charges for legal services in connection with the negotiation of a property division and separation agreement.

In this connection plaintiff contends that the legal fees were paid in connection with the preservation of his position as a stockholder, director, and officer of the du Pont Company and that said fees are deductible under the provisions of section 212(1)(2) of the Internal Revenue Code of 1954, *supra.*

At the outset of the discussion respecting this issue, we point out that the taxpayer is not entitled to a deduction for personal, living or family expenses under section 262 of the Internal Revenue Code of 1954, *supra*, and Treasury Regulation § 1.262–1(b)(7).

Section 262 of the Internal Revenue Code of 1954, *supra*, reads as follows:

> PERSONAL, LIVING, AND FAMILY EXPENSES
>
> Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living or family expenses.

Treasury Regulation section 1.262–1(b)(7) provides:

> Personal, Living, and Family Expenses.—(a) *In general.* In computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, for personal, living and family expenses.
>
> (b) Examples of personal, living, and family expenses. Personal, living, and family expenses are illustrated in the following examples:
>
> *     *     *     *     *

> (7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either husband or the wife. * * *

Therefore, in order to bring himself under the section permitting the deduction, plaintiff must show that the legal expenses were incurred in matters directly related to his business or the management, conservation or maintenance of property held for the production of income. See *Port* v. *United States*, 143 Ct. Cl. 334.

Plaintiff cites the cases of *McMurtry* v. *United States*, 132 Ct. Cl. 418 (1955); *Baer* v. *Commissioner*, 196 F. 2d 646 (1952); *Bowers* v. *Commissioner*, 243 F. 2d 904 (1957); and *Fisher* v. *United States*, 157 F. Supp. 364 (1957).

Defendant in opposition cites the U.S. Supreme Court decision in the case of *Lykes* v. *United States*, 343 U.S. 118 (1951), wherein the Supreme Court reviewed the legislative history of section 23(a)(2) of the 1939 Code, the predecessor to section 212 of the 1954 Code, which showed that Congress intended to allow deduction for income-producing activities of a commercial nature only and did not intend to allow the deduction of any expense designed to aid taxpayer to retain their property. The Supreme Court in *Lykes* stated at page 125:

> Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. That argument would carry us too far. It would mean that the expense of defending almost any claim would be deductible by a taxpayer on the ground that such defense was made to help him keep clear of liens whatever income-producing property he might have.

Admittedly, some courts have departed from the philosophy of the *Lykes* decision. *Baer* v. *Commissioner, supra; McMurtry* v. *United States, supra; Bowers* v. *Commissioner, supra; Owens* v. *Commissioner*, 273 F. 2d 251 (1959); *Fisher* v. *United States, supra;* and *Patrick* v. *United States*, 186 F. Supp. 48 (1960). However, many courts have not followed the departure or have distinguished the case on factual grounds. *Lewis* v. *Commissioner*, 253 F. 2d 821 (1958);

*Tressler* v. *Commissioner*, 228 F. 2d 356 (1955); *Howard* v. *Commissioner*, 202 F. 2d 28 (1953); *Richardson* v. *Commissioner*, 234 F. 2d 248 (1956); *Smith's Estate* v. *Commissioner*, 208 F. 2d 349 (1953); *Donnelly* v. *Commissioner*, 16 T.C. 1196 (1951); *Estate of Walsh* v. *Commissioner*, 28 T.C. 1274 (1957); *Douglas* v. *Commissioner*, 33 T.C. 349 (1959).

Of course, the defendant contends the rule in the *Lykes* case as followed by the court in the case of *Lewis* v. *Commissioner*, *supra*, is correct. On the other hand, plaintiff is just as positive that the *McMurtry*, *Baer*, *etc.*, cases provide the correct rule.

However, we believe that it is not necessary here to choose which decision is correct in the premises. We believe the cases cited by plaintiff are factually distinguishable from the facts in the case at bar.

The *McMurtry* decision, *supra*, related to a situation wherein the plaintiff's position to some extent depended on the amount of his stockholdings in the company.

In the *Baer* case, *supra*, the taxpayer owned a controlling interest in a closely held corporation and to have acceded to his wife's demands would have resulted in not only loss of control of the company and loss of dividends, but no doubt would have resulted in loss of his salary as well, if other and adverse parties gained control.

In *Bowers* v. *Commissioner*, *supra*, and *Patrick* v. *United States*, *supra*, as well as *Fisher* v. *United States*, *supra*, practically the same situation as in *Baer*, *supra*, existed. It was necessary for *Bowers* to retain the stock in order to maintain his control, management and income.

In the present case by contrast, almost all the legal expenses were incurred by reason of the marital rift between Mr. and Mrs. Davis. As a consequence thereof, his attorney's fees were practically all incurred in an effort to hold to a minimum the amount necessary to effect a property settlement. It naturally follows that the attorney's fees paid for Mrs. Davis' attorney were to gain a maximum amount in the property settlement agreement. Furthermore, we believe from the evidence that in any event plaintiff has failed to prove that retention of the stock was necessary

to maintain him as an officer and director of du Pont. As a matter of fact, at the time of Davis' election to the Board, his stockholdings were substantially less than those of any other person nominated by the management for election to the Board. Furthermore, during Mr. Davis' service as a director, every person nominated by the management of du Pont was elected by the stockholders as a director.

Therefore, we think the facts of this case more nearly come under the rule laid down by the court in the cases of *Lewis* v. *Commissioner, supra; Tressler* v. *Commissioner, supra; Howard* v. *Commissioner, supra; Richardson* v. *Commissioner, supra; Smith's Estate* v. *Commissioner, supra; Donnelly* v. *Commissioner, supra; Estate of Walsh* v. *Commissioner, supra; Douglas* v. *Commissioner, supra.*

The above cases all stand for the proposition that attorneys' fees generally seek to conserve estates but are not necessarily the basis for a deduction under the Internal Revenue Code. Thus we believe the rule of the *Lewis* case, *supra*, is the correct one in these premises; *i.e.*, following the Supreme Court's decision in *Lykes* v. *United States, supra*, the Court held that the legal expenses were not deductible. The above reasoning was followed by this court in the case of *Port* v. *United States, supra.*

Thus we hold that the attorneys' fees paid to both lawyers constituted personal expenses which are nondeductible under section 262 of the 1954 Code, *supra.*

The next and final contention of the taxpayer is that the taxpayer did not realize taxable gain by virtue of the stock transfer to his former wife pursuant to the property settlement agreement, and consequently the inclusion in income of the net long-term capital gain was erroneous.

The facts respecting the above situation are these: Pursuant to the separation agreement the taxpayer, Davis, transferred 500 shares of du Pont stock to his former wife, Alice M. Davis, in 1954. The taxpayer's cost basis of the stock was $74,775.37 and the fair market value at the time of transfer was $82,250. The difference was taxed as capital gain under section 1001 of the Internal Revenue Code of 1954. 26 U.S.C. § 1001 (1958 Ed.) which provides:

## DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Plaintiff contends that the transfer of the stock was not in satisfaction of Alice M. Davis' right to support and maintenance, but was a part of a division of property. Plaintiff argues that Mrs. Davis' rights to support and maintenance were satisfied by the payment of $550 per month and the payment of dividends on a maximum of 1,000 shares of du Pont stock. This is so, plaintiff says, because the division of property was contained in one paragraph of the separation agreement, whereas the payments in lieu of alimony were in another paragraph.

It is the defendant's contention that under the rule laid down in the case of *Commissioner* v. *Mesta*, 123 F. 2d 986 (1941), cert. denied 316 U.S. 695 (1942), and *Commissioner* v. *Halliwell*, 131 F. 2d 642 (1942), cert. denied 319 U.S. 741, the increment in value was clearly taxable gain.

Plaintiff then argues the incorrectness of the *Mesta* decision, *supra*, and concludes with the statement in his brief that "plaintiffs are not prepared to concede the correctness of the *Mesta* decision, but believe that since the rule of that case is not here applicable it is not necessary to further consider the *Mesta* case." Plaintiff further contends that the *Mesta* decision is not applicable because that case involved a transfer of property in connection with a division of property and not a transfer in satisfaction of the husband's (plaintiff Davis) obligation to support. To support this contention plaintiff cites the case of *Commissioner* v. *Marshman*, 279 F. 2d 27 (1960), cert. denied — U.S. —.

Thus the situation is this: The Court of Appeals in the Third Circuit in a case involving an almost identical proposition, in 1941 found that there was a taxable capital gain. The Supreme Court denied certiorari. In 1942 the Court of Appeals, Second Circuit, in a substantially same situation reversed the Tax Court and found against the taxpayer. *Commissioner* v. *Halliwell*, *supra*. The Supreme Court denied certiorari. The ruling in the *Mesta* case, *supra*, was cited with approval and followed by the court in *Halliwell*. Then in 1960, after the Tax Court had followed the 1941 and 1942 decisions, the Court of Appeals for the Sixth Circuit in the *Marshman* case, *supra*, reversed the Tax Court and specifically rejected the rule of the two cases in the Second and Third Circuit. The *Marshman* situation also is almost identical with the facts in the instant case. On December 12, 1960, the Supreme Court denied certiorari in the *Marshman* case. The result is that we are faced with two precedents pointing in opposite directions and an attempt to distinguish the two is impossible.

Since there is no clear ground for distinguishment between the rule of the *Mesta-Halliwell* cases and the *Marshman* case, it behooves us to decide which rule is the correct one in the premises. While admittedly it is a troublesome question, we are of the opinion that the facts of the instant case more nearly come under the reasoning and the rule of the *Marshman case*. We say this because the statute, section 1001(b), expressly states that the amount realized from the sale or other disposition of property shall be the sum of any money *received* plus the fair market value of the property *received*. We think as did the court in *Marshman*, *supra*, that the measurement of gain cannot be the fair market value of the property transferred. We also believe, as did the court in *Marshman*, that the measure of the value of the wife's right to maintenance and support was dependent upon so many uncertain factors that neither the taxpayer nor a revenue officer could do more than guess at it.

Furthermore, to say that the fair market value of the property received is the same as the fair market value of the property given up, is the use of a formula different from the well-established formula for determining fair market value.

Fair market value is the price at which property would change hands between a willing seller and a willing buyer, neither being under any compulsion to buy or sell. Again we agree with the court in the *Marshman* case that a transaction between a husband and a wife made under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule.

Under the evidence of this case, like *Marshman*, many demands were made, many concessions were made, and under these circumstances values are lost sight of. This is especially true under the circumstances of this case wherein the husband even became ill because of the tensions resulting from the marital troubles. So it is reasonable to say that in some measure the husband was willing to pay at least some amount in order to have the marriage terminated. In these circumstances, the value of what was given up is no criterion of the fair market value of the "property" received.

For the above reasons, we cannot agree with the ruling in the *Mesta* case that the fair market value of the release by a wife of her alimony and dower rights against her husband and his estate is properly determined by ascertaining and giving to it the fair market value of the property which she received from her husband.

If the "property" received by Davis had no fair market value, or if none has been shown, it may be economic gain but it is not taxable gain by reason of the express provision of section 1001(b). *Champlin* v. *Commissioner*, 71 F. 2d 23, 29.

Therefore, we believe that T. C. Davis did not realize taxable gain by virtue of the 1955 transfer of stock pursuant to the property settlement agreement. Consequently, plaintiff is entitled to recover the amount paid pursuant to the inclusion of capital gain in his 1955 tax, in addition to the amount paid by reason of the inclusion of attorney's fees paid his attorney for tax advice.

The exact amount of recovery will be determined pursuant to Rule 38(c).

It is so ordered.

DURFEE, *Judge;* MADDEN, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge*, concur.

### FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner Roald A. Hogenson, and the briefs and argument of counsel, makes findings of fact as follows:

**1.** Plaintiffs are citizens of the United States and residents of the State of Delaware. At the end of the calendar year 1955, they were husband and wife.

**2.** Plaintiff, Thomas Crawley Davis, had been previously married to Alice M. Davis, such marriage having existed from March 1, 1941, to January 5, 1955. On the latter date, Alice M. Davis, hereinafter referred to as Mrs. Davis, was granted an absolute and final decree of divorce from Mr. Davis upon the stated ground of "extreme cruelty, mental in nature," by the Second Judicial District Court of the State of Nevada. The separation and property settlement agreement of the parties, hereinafter mentioned in these findings, was approved by the Nevada court and incorporated by reference in its decree which, by its terms, ordered and directed the parties to comply with and to execute the terms and conditions of the agreement. Both parties were represented at the proceedings by Nevada attorneys who had not participated in any way in the preparation and execution of the agreement. Mrs. Davis appeared in person at the trial, but Mr. Davis did not personally participate.

**3.** Since 1934, Mr. Davis has been associated with E. I. du Pont de Nemours & Company, hereinafter referred to as du Pont or the company, in various capacities as an employee, officer, director and stockholder. His employment record with du Pont from November 16, 1934, to the date of the trial of this case on April 30, 1959, was as follows:

11-16-34 to 11-30-41 Manager, Tax Division, Treasurer's Department
12-1-41 to 8-26-44 Assistant Comptroller, Treasurer's Department
8-27-44 to 5-19-46 Assistant Treasurer, Treasurer's Department
5-20-46 to 1-18-48 First Assistant Treasurer, Treasurer's Department
1-19-48 to 12-20-53 Treasurer of the company
12-21-53 to 4-30-59 Member, Board of Directors, Member, Executive Committee, Vice President
11-1-54 to 4-30-59 Member, Finance Committee

4. From 1902 to the present time, du Pont has had a policy and practice of granting bonuses to its officers and employees. Prior to 1943, such bonuses were awarded in the form of du Pont stock. Due to the impact of the Federal withholding tax on incomes, such bonus awards were paid entirely in cash from 1943 to 1946. Beginning in 1947, such bonuses were paid partly in du Pont stock and partly in cash.

One of the primary purposes of the company in awarding bonuses in the form of stock was to tie the bonus awardees to the company as stockholders and thus intensify their interest in the company's business. It was generally known that the company's top officials expected bonus awardees to retain their du Pont stock, the recognized exceptions being in cases of necessity to sell bonus stock to pay income taxes or to purchase a suitable home.

5. Prior to the annual meeting of the du Pont stockholders, the secretary of the company each year prepares an analysis of the holdings and dispositions of stock by executives of the company. The president, vice presidents, and directors are and were expected to explain any substantial disposition of their stock.

Proxy statements issued by du Pont to its stockholders prior to each annual meeting show the holdings of du Pont stock by those persons nominated by the du Pont management for election or reelection by the stockholders to the company's board of directors.

6. During November 1953, Mr. Davis was advised by the president and by the chairman of the board of du Pont that he was being considered for election as a director, vice president and member of the executive committee of the company. At that time Mr. Davis had 2,842 shares of du Pont common stock registered in his name.

Effective December 21, 1953, Mr Davis was elected by the board of directors as a director, vice president, and member of the executive committee of du Pont. As a director, Mr. Davis was subject to reelection by the stockholders at the succeeding annual meetings in April of each year. Mr. Davis has continued to hold such offices up to the present time. Since November 1, 1954, Mr. Davis has also been a member of the finance committee of the company.

**7.** The changes in the du Pont stock holdings of Mr. Davis from February 28, 1953, through 1958, were as follows:

| | Shares in | Shares out | Shares remaining |
|---|---|---|---|
| Feb. 28, 1953 | | | 2,302 |
| Mar. 5, 1953 | 421 | | 2,723 |
| July 27, 1953 | 319 | | 3,042 |
| Sept. 1, 1953 | | 200 | 2,842 |
| Mar. 4, 1954 | 574 | | 3,416 |
| Mar. 18, 1954 | | 100 | 3,316 |
| Apr. 27, 1954 | | 100 | 3,216 |
| Oct. 7, 1954 | | 100 | 3,112 |
| Nov. 22, 1954 | | 100 | 3,016 |
| Mar. 3, 1955 | 65 | | 3,081 |
| Mar. 21, 1955 | | 500 | 2,581 |
| Jan. 30, 1956 | | 7 | 2,574 |
| Feb. 29, 1956 | 44 | | 2,618 |
| Mar. 21, 1956 | | 100 | 2,518 |
| Mar. 27, 1956 | | 500 | 2,018 |
| Feb. 27, 1957 | 286 | | 2,304 |
| Oct. 15, 1957 | | 10 | 2,294 |
| Dec. 16, 1957 | | 6 | 2,288 |
| July 18, 1958 | | 16 | 2,272 |

The disposition of 200 shares on September 1, 1953, 500 shares on March 21, 1955, and 500 shares on March 27, 1956, were to Mrs. Davis, as hereinafter related in these findings. The evidence indicates that the other dispositions were in the main for the purpose of paying Federal income taxes, and meeting the cash payments required by the separation and property settlement agreement.

All of Mr. Davis' du Pont stock holdings were acquired by him through bonus awards by the company.

**8.** The income of Mr. Davis for the years 1949 through 1953 was as follows:

| | 1949 | 1950 | 1951 | 1952 | 1953 |
|---|---|---|---|---|---|
| Salary and bonus from du Pont | $86,117.43 | $114,405.08 | $147,767.14 | $169,612.22 | $204,998.66 |
| Dividends on du Pont stock | 3,931.30 | 7,653.65 | 6,360.70 | 7,405.65 | 9,082.75 |
| Other income, or capital gains or loss | (856.22) | 3,470.51 | 695.28 | | |
| Totals | 89,192.51 | 125,529.24 | 154,823.12 | 177,017.87 | 214,081.41 |

**9.** For the calendar years 1954 and 1955, Mr. Davis' adjusted gross income amounted to the respective sums of $264,984.69 and $317,865.16, of which the following represented payments from du Pont:

| | 1954 | 1955 |
|---|---|---|
| Salary | $87,437.48 | $90,600.00 |
| Dividends treated as salary | 4,090.00 | 3,592.75 |
| | 91,527.48 | 94,192.75 |
| Bonus | 152,705.97 | 208,016.27 |
| Director's fees | 550.00 | 500.00 |
| Dividends on du Pont stock | 13,239.02 | 15,036.00 |
| Totals | 258,022.47 | 317,745.02 |

10. Mr. Davis' net worth statement as of July 1, 1954, was as follows:

| | | |
|---|---|---|
| Cash in bank—Wilmington Trust Co | | $28,073 |
| Shares of du Pont common stock: | | |
| Registered in his name | 3,216 shares | |
| Deduct: held by company as unearned bonus | 802 shares | |
| Remainder (including 100 shares pledged to Farmers Bank) | 2,414 shares @ $134.25 | 324,079 |
| Insurance policies having cash surrender value: | | |
| Travelers Insurance Co. $10M policy | | 5,000 |
| U.S. Veterans Administration $10M policy | | 5,000 |
| Great Western Life Assurance Co. $50M policy | | 21,717 |
| Pan American Life Assurance Co. $50M policy | | 17,493 |
| Dominion Life Assurance Co. $50M policy | | 16,407 |
| Home on Kennett Pike | | 76,000 |
| Home furnishings | | 15,000 |
| Automobiles (3) | | 3,000 |
| | | 511,769 |
| 1954 Federal income tax unpaid | $82,079 | |
| Mortgage on home | 18,000 | |
| Borrowing from Farmers Bank | 63,761 | |
| | | $163,840 |
| Net Worth—July 1, 1954 | | 347,929 |

As of July 1, 1954, delivery of 802 of the 3,216 shares of du Pont stock registered in Mr. Davis' name had been deferred to later years. Under the du Pont bonus plan, the 802 shares were subject to forfeiture in the event that prior to actual delivery to him, Mr. Davis' services with du Pont were terminated other than through death or retirement pursuant to the company's program.

All of the property of the parties involved in the property settlement negotiations was owned by Mr. Davis subject only to the marital rights of Mrs. Davis under the laws of the State of Delaware.

11. For a period of many years, Mr. and Mrs. Davis had had many disagreements of a personal nature, which finally led Mrs. Davis to seek a separation in June 1954. About the middle of the year 1953, Mrs. Davis requested Mr. Davis to transfer one-half of his property into her name, including 1,500 shares of du Pont stock, but she did not then request a divorce or separation. Mr. Davis rejected these property demands, but offered to make future transfers of du Pont stock to Mrs. Davis as long as his stock holdings did not fall below 3,000 shares. Mr. Davis advised Mrs. Davis that otherwise his position with du Pont would be seriously jeopardized by stock transfers. On September 1, 1953, Mr. Davis transferred 200 shares of du Pont stock to Mrs. Davis to allay her demands. By December 1953, their relations had become so strained that they could not converse without quarrelling and there was great unhappiness in their home. Mrs. Davis' demands for a property division became more insistent, and in February 1954 she refused to sign a joint Federal income tax return until her request for property had been met.

In tho week preceding June 15, 1954, Mrs. Davis consulted an attorney, Mr. James R. Morford, concerning her marital troubles and about obtaining a property settlement. Mrs. Davis then advised Mr. Davis that she had retained Mr. Morford, and requested Mr. Davis to retain an attorney to negotitate a separation agreement. Mrs. Davis' primary purpose in seeking a separation was to terminate a marital relationship which, for personal reasons, had not been successful. Mr. Davis at first declined, and refused to discuss a separation agreement or property settlement, but thereafter in the summer of 1954 retained an attorney, Mr. H. Albert Young, to represent him. At Mr. Davis' request, Mr. Young requested Mr. Morford to make an effort to accomplish a reconciliation of the parties, but Mrs. Davis rejected the proposal after a conference with her attorney.

12. Mrs. Davis' initial proposal for a property settlement and separation agreement was made through the respective

attorneys to Mr. Davis on July 13, 1954. Mrs. Davis proposed that she would move from the home of the parties, receive one-half of the appraised value of the home and furnishings, take one automobile, receive 1,500 shares of du Pont stock, a sufficient annual payment to pay the interest on an insurance loan, have custody of the minor child, and receive $400 per month for support of the child. As a first alternative, Mrs. Davis proposed that in lieu of the 1,500 shares of du Pont stock she would accept $1,000 per month for life with the understanding that she would support the child. As a second alternative, Mrs. Davis proposed that in lieu of immediate delivery of the du Pont stock, she would accept the $1,000 per month payment until Mr. Davis' retirement from du Pont, and then in lieu of any subsequent support payments, transfer of 1,500 shares of du Pont stock upon his retirement.

On August 24, 1954, Mr. Davis made a counterproposal through the respective attorneys to award one of the automobiles to Mrs. Davis, pay her $24,000 for one-half of the net value of the home and furnishings, pay off the $18,587.99 loan on a $50,000 insurance policy and award Mrs. Davis this policy, on condition she pay future premiums, award Mrs. Davis two unencumbered insurance policies aggregating $20,000 on the condition she assume future premium payments, to create an irrevocable trust for the minor child and pay $700 per quarter for 40 quarters, or $28,000 in 10 years, into a trust estate to be disbursed by the trustee for the support and education of the minor child, and to pay $18,000 per annum for ten years in quarterly installments to Mrs. Davis for her support and maintenance, with no stock to be transferred. Mr. Davis later amended this proposal by increasing the proposed cash payment for the one-half value of the house and furnishings from $24,000 to $30,000.

These proposals and counterproposals having been successively rejected, a conference was held between Mr. and Mrs. Davis and their respective attorneys, and the parties then accomplished and executed the formal property settlement and separation agreement, dated November 4, 1954, included in the Nevada decree of divorce, and hereinafter related in these findings.

**13.** The separation and property settlement agreement recited that various disputes and differences had arisen between the husband and wife, and that they had permanently separated. It was further recited that "the parties hereto intend by this agreement to settle their respective rights and obligations against and to one another by (1) making a division of their property; (2) providing in lieu of alimony in the event of a decree of divorce for the support and maintenance of the wife; (3) making an arrangement and provision for the support and maintenance of Stephen; and (4) defining the rights of custody, maintenance, support and education of their minor child."

The agreement then provided a "division in settlement of their property." Mr. Davis was awarded the home property and all furnishings and personal property thereon on condition that he pay Mrs. Davis $30,000 in cash and that Mrs. Davis have a certain automobile and certain listed items of furniture and furnishings. Mr. Davis agreed to make future transfers of a total of 1,000 shares of du Pont stock to Mrs. Davis, 500 shares on April 1, 1955, and 500 shares on April 1, 1956. Mr. Davis also agreed to deliver to his wife as owner-beneficiary, not later than February 28, 1955, the following life insurance policies, free of all liens and encumbrances: the fully paid-up Dominion Life Assurance Company policy for $50,000; and the two New England Mutual Life Assurance Company policies, each for $10,000 and each having premiums fully paid to September 20, 1955. Mrs. Davis agreed to relinquish all rights to any other insurance policy.

Mr. Davis agreed to pay to Mrs. Davis "for her maintenance and support" the sum of $2,500 on December 15, 1954, and $550 per month payable on the first day of each month for the ten-year period from November 1, 1954, to October 1, 1964. Mrs. Davis agreed that she would accept these payment "in lieu of all claims against the husband for maintenance and support, past, present, and future."

Mr. Davis also agreed to pay to Mrs. Davis "for her maintenance and support" a sum of money equivalent to the per-share dividend thereafter declared on du Pont stock, multiplied by the number of shares which, by the agreement of the parties, was to be transferred to Mrs. Davis in the

future, but which number of shares remained untransferred at the effective date of the dividend payment.

Mrs. Davis agreed to accept "the division of property herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise."

The agreement recited that Mrs. Davis would have the custody of the minor child of the parties, subject to reasonable visitation by Mr. Davis, and also provided that Mr. Davis would create an irrevocable trust, by executing an instrument in the form of that attached to the agreement, to provide "for the support, maintenance and education" of the minor child, and pay $700 per quarter-year commencing January 1, 1955, for 40 quarters, or ten years, into the trust estate, to be expended by the trustee for the education and use and benefit of the minor child. The agreement also required Mr. Davis to provide a $10,000 life insurance policy for the protection of the trust estate.

Both parties agreed to execute instruments necessary to carry the agreement into effect, and Mrs. Davis agreed to sign a joint Federal income tax return for 1954.

The agreement provided for a mutual release of all other debts, claims, and obligations, and also that Mrs. Davis upon the performance of Mr. Davis' undertakings waived all claims which she might otherwise have to any of the property of Mr. Davis and to any claim for support or maintenance of herself or the minor child.

The agreement further provided that in the event a decree of divorce should be granted, dissolving the marriage, the provisions of the agreement might, but need not be, incorporated into such decree, subject to the approval of the court granting such divorce.

**14.** Throughout the negotiations for the separation and property settlement agreement, and in property discussions prior thereto, Mr. Davis reasonably and honestly believed that immediate transfer to Mrs. Davis of 1,500 shares of du Pont stock would seriously jeopardize his chances of

election and reelection as a member of the du Pont board of directors, as a member of its executive committee and as a vice president of the company. He consistently related this belief to Mrs. Davis and to their respective attorneys, and resisted transfer of any stock until and in conformity with the settlement and separation agreement of November 4, 1954. Mr. Davis believed that his associates in the top management of du Pont would understand and accept the necessity of transfer of stock in connection with the property settlement and separation agreement, but thought that it would not be acceptable to the stockholders in their election of the directors at their annual meetings.

At the time of his election to the board of directors of du Pont, Mr. Davis' stock holdings in the company were substantially less than those of any other person nominated by the management for election to the board. In subsequent years, only two directors, both of whom were recognized scientists, held fewer du Pont shares than Mr. Davis. Mr. Davis continued to be renominated by the management and reelected by the stockholders as a member of the board despite the transfers of his shares, as shown in finding 7. During Mr. Davis' service as a director, every person nominated by the management of du Pont was elected by the stockholders as a director.

**15.** Neither Mr. Young as attorney for Mr. Davis, nor Mr. Morford as attorney for Mrs. Davis, acted for either party in connection with the suit for divorce in Nevada, except that Mr. Young by telephone engaged a Nevada law firm which independently handled the proceedings.

**16.** The matter of obtaining a decree of divorce or decree of legal separation was not proposed by either Mr. Davis or Mrs. Davis until November 1954. The marital difficulties had caused Mr. Davis such great discomfort and emotional upset that it had been necessary for him to be hospitalized. Mr. Davis concluded and advised Mrs. Davis that from his standpoint a divorce should be obtained. Thereafter discussions were carried on between Mrs. Davis, Mr. Morford, and Mr. Young about divorce proceedings, and the Nevada divorce suit was thereafter prosecuted by Nevada attorneys.

**17.** In negotiating the separation and property settlement agreement, both Mr. Young and Mr. Morford considered

the federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client, and this same concentration for the interests of his own client was practiced by each attorney in negotiating the overall aspects of the property settlement agreement.

18. Both Mr. Young and Mr. Morford had had many years of experience as successful practicing lawyers in the State of Delaware. In the negotiations involved in this case, they advised Mr. Davis that it was the practice in conformity with Delaware law that the husband pay the attorneys' fees of both parties in connection with negotiations for a separation and property settlement agreement. As a result of this advice, Mr. Davis understood that he had to pay the fees of Mrs. Davis' attorney, and agreed to do so.

19. The separation and property settlement agreement contained no provisions concerning payment of attorneys' fees. However, in accordance with the oral understanding, Mr. Davis paid to his own attorney, Mr. Young, total fees in the sum of $12,506, and total fees to Mrs. Davis' attorney, Mr. Morford, in the sum of $10,000.

On November 17, 1954, Mr. Young provided Mr. Davis with two separate bills, one for $7,506, for his services "Re: Separation Agreement and Property Division between T. C. Davis and Alice M. Davis," and the other for $5,000 for his services "Re: Tax matters in the case of Davis v. Davis." Each of these bills showed that Mr. Davis had made a payment of $2,500 on each of them on November 16, 1954, leaving respective balances of $5,006 and $2,500.

On December 16, 1954, Mr. Morford provided Mr. Davis with two separate bills, one for $5,000 "To professional services in the matter of division of property and the preparation of separation agreement between T. Crawley Davis and Alice M. Davis," and the other for $5,000 "To professional services rendered in connection with tax matters involved in the matter of Alice M. Davis versus T. Crawley Davis." Each of these bills showed that Mr. Davis had made a payment of $2,500 on each of them on November 14, 1954, leaving a balance on each bill of $2,500.

On January 27, 1955, Mr. Davis paid his attorney, Mr. Young, the sums of $5,006 and $2,500, being the balances on the two bills submitted to him by Mr. Young.

On January 27, 1955, Mr. Davis made two payments to Mrs. Davis' attorney, Mr. Morford, of $2,500 each, being the respective balances on the two bills submitted to him by Mr. Morford.

Mr. Morford testified in this case that he split his overall fee into two categories at the request of Mr. Davis, and that he could not possibly segregate his fee in such manner and justify the amount of one bill as against the other. He later testified that tax problems underlaid the whole relationship of the parties and that his general opinion was that the segregation of the total fee, as it was done at the request of Mr. Davis, appeared to him to be entirely reasonable. In his appearance as a witness in this case, Mr. Young's testimony was vague and general as to the reasonableness and propriety of the division of his overall fee into the two categories, and he did not state whether the segregation was made by him independently or at the suggestion of Mr. Davis.

**20.** There is no testimony or evidence in this case from which it can be determined the extent to which the attorneys' fees paid by Mr. Davis either to Mr. Young or to Mr. Morford were reasonably allocable to the effort of Mr. Davis to retain his shares of du Pont stock and thereby to preserve his position and earning capacity with the du Pont company.

**21.** On March 21, 1955, Mr. Davis transferred to Mrs. Davis 500 shares of du Pont common stock pursuant to the terms of the property settlement agreement.

**22.** On or before April 15, 1956, plaintiffs filed their joint Federal income tax return for the calendar year 1955 with the District Director of Internal Revenue for Delaware. Such return showed taxable income of $276,374.43 and net tax payable of $202,014.52. The latter amount was duly paid on or before April 15, 1956.

In this 1955 return, plaintiffs claimed as a deduction legal fees in the amount of $5,000. These legal fees were the two payments of $2,500 each, one made to Mr. Young and the

other to Mr. Morford, as related in finding 19, covering the respective unpaid balances on the bills of the attorneys for tax services in connection with the separation and property settlement agreement. The plaintiffs did not include as deductions the other legal fees of $5,006 paid to Mr. Young, and $2,500 paid to Mr. Morford, on January 27, 1955.

23. In connection with the audit of plaintiffs' income tax return for 1955, the agent of the Internal Revenue Service proposed to assess a tax deficiency in the sum of $6,318.66 on the basis of disallowance of the deduction of $5,000 for legal fees and on the basis of including in plaintiffs' gross income a net long-term capital gain of $3,737.21, representing the difference between the tax basis to Mr. Davis of the 500 shares of du Pont stock transferred to Alice M. Davis during 1955 and the fair market value of such shares as of the date of the transfer to her.

Mr. Davis had a cost basis of $74,775.37 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955. This stock had a fair market value on that date of $82,250, or an increase in value over the cost basis of $7,474.63, one-half of which gain, or $3,737.31, was taken into account in the proposed deficiency assessment.

24. On February 14, 1958, Mr. Davis paid to the District Director the amount of $6,961.95, representing the asserted deficiency for 1955 in the amount of $6,318.66 plus interest of $643.29.

25. On April 8, 1958, plaintiffs filed their claim for refund of Federal income taxes paid for 1955 in the sum of $13,642.29. This claim was based on the failure to include all of the $12,506 of legal fees paid by Mr. Davis to Mr. Young and Mr. Morford on January 27, 1955, as related in finding 19. Plaintiffs asserted in their claim that $2,500 was on that date paid to each attorney, or a total of $5,000, for legal services in connection with various Federal tax matters arising out of negotiations and execution of the separation and property settlement agreement. Plaintiffs further asserted that additional sums as legal fees, $5,006 to Mr. Young and $2,500 to Mr. Morford, were paid on January 27, 1955, for services in connection with the negotiations and execution of the same agreement, primarily

incurred in connection with the protection of Mr. Davis' position as a stockholder, officer, and director of du Pont.

This claim further asserted that the inclusion in income of the net long-term capital gain of $3,737.31 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955, was erroneous, because such transfer was pursuant to the same separation and property division agreement and did not result in any income or gain to the taxpayer.

**26.** By registered letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified plaintiffs of the disallowance in full of their claim for refund for the year 1955.

## CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment will be entered to that effect.

The amount of recovery will be determined pursuant to rule 38(c) of the rules of this court.

U.S. GOVERNMENT PRINTING OFFICE: 1961

IN THE

# Supreme Court of the United States

October Term, 1961.

No. 190.

UNITED STATES,
*Petitioner,*

*v.*

THOMAS CRAWLEY DAVIS and GRACE ETHEL DAVIS,
*Respondents.*

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

CONVERSE MURDOCH,
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IN THE

# Supreme Court of the United States.

OCTOBER TERM, 1961.

No. 190.

UNITED STATES,

*Petitioner,*

*v.*

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS,

*Respondents.*

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

The government has advanced two reasons for review of the Court of Claims decision that the taxpayer realized no taxable gain on account of his transfer of stock to his wife.

First, the government alleges that the Court of Claims decision is in conflict with the decisions of the Courts of Appeal for the Second and Third Circuits. The taxpayers will demonstrate in this brief that *under the facts in this case* there is no real conflict between the decision of the Court of Claims in this case and the decisions of any other courts.

Secondly, the government asserts that the decision of the Court of Claims involves an important issue of law which, if decided in the taxpayers' favor, will result in the elimination of all income tax on the appreciation in value of property transferred in connection with marital settlements incident to separations or divorces. Taxpayers will demonstrate that the decision of the Court of Claims does not cause the result suggested in the petition for certiorari.

## STATEMENT OF THE CASE.

The taxpayers accept the government's statement of the case with one exception.

The government's statement of the case fails to adequately point up a fact which has an all-important bearing on the question whether this Court should review the decision of the Court of Claims. In the separation and property settlement agreement between Thomas Crawley Davis and his wife, Alice M. Davis, the parties and their counsel were careful to specify as separate items the amounts to be paid by Mr. Davis in discharge of his marital obligation to maintain and support his wife and their minor child. Paragraphs 5, 6, and 8 of the November 4, 1954 agreement between T. Crawley Davis and Alice M. Davis (R. 9, 10, Petition to Ct. Cls., Exh. A, par. 6). On the other hand, as a completely separate item, in paragraph 3 of the November 4, 1954 agreement the parties provided for "division in settlement of their property" (R. 7-9, Petition to Ct. Cls., Exh. A, par. 6). It was pursuant to the last-mentioned separate provision of the agreement that there occurred the transfer of stock which raised the issue with respect to which the government now seeks review by this Court.

## ARGUMENT.

The government contends that the decision of the Court of Claims holding that the husband taxpayer realized no taxable gain on account of his transfer of stock to his wife should be reviewed by this Court on the following grounds:

1. Because the Court of Claims decision is alleged to be in conflict with the decisions of the Court of Appeals for the Second and Third Circuits in *Commissioner v. Mesta*, 123 F. (2d) 986 (3rd Cir. 1941) *cert. den.* 316 U. S. 695 (1942), and *Commissioner v. Halliwell*, 131 F. (2d) 642 (2nd Cir. 1942) *cert. den.* 319 U. S. 741 (1943).

2. Because the legal issue involved is important to the revenue and a failure to reverse the Court of Claims decision on this issue will result in a loss of revenue through elimination of all income tax on the appreciation in value of property transferred in connection with marital settlements incident to separations and divorces.

Both of these grounds are demonstrably untenable and the petition for a writ of certiorari should accordingly be denied.

### There Is No Real Conflict Between the Decision of the Court of Claims and the Mesta and Halliwell Decisions.

In the *Mesta* and *Halliwell* cases the Courts of Appeals for the Third and Second Circuits decided that a husband realized taxable gain when he transferred appreciated property to his wife in discharge of his legal obligation to maintain and support her. In reaching this result, both Courts of Appeal reversed contrary decisions of the Board of Tax Appeals.[1] The lack of real conflict between the Court of Claims decision in this case and the decisions

1. *L. W. Mesta*, 42 B. T. A. 933 (1940) and *Walter S. Halliwell*, 44 B. T. A. 740 (1941).

in the *Mesta* and *Halliwell* cases is best pointed up by a significant omission of language in the government's petition. At pages 4 and 5 of the petition it is stated:

> "* * * On their facts, both cases [*Mesta* and *Halliwell*] are indistinguishable from the case at bar. In each, *precisely as in this case*, a husband transferred appreciated stock to his wife pursuant to a property settlement. In each, the wife, in return, released all claims to maintenance and support and all rights to share in the husband's estate. * * *" (Emphasis supplied.)

In the first of the above-quoted sentences the government equated its description of the *Mesta* and *Halliwell* situations with that present in this case by noting that in the *Mesta* and *Halliwell* cases, "*precisely as in this case*" the husband transferred appreciated stock "pursuant to a property settlement." However, it is significant that in the second of the above-quoted sentences the government did not (because it could not) similarly equate the situation in the instant case with those in the *Mesta* and *Halliwell* cases wherein the wife released her claims for maintenance and support in return for the transfer of appreciated securities. Therein lies the significant difference between this case and the *Mesta* and *Halliwell* cases. The record in this case is devoid of any basis for the assertion that Mr. Davis transferred securities to his wife in discharge of an obligation of support and maintenance. If Mr. Davis had transferred appreciated securities to his wife in discharge of his obligation to support and maintain her, the taxpayers would agree that the Court of Claims decision on this point creates a conflict with the *Mesta* and *Halliwell* decisions. The contrary being the fact, there is no conflict between the Court of Claims decision in this case and the *Mesta* and *Halliwell* decision.

The mentioned distinction between the instant case and the *Mesta* and *Halliwell* cases has been recognized in

decided cases. It is the very distinction which the government itself has successfully urged.

In *Ida Lucille Swanson v. Earl R. Wiseman*, 61-1 U. S. T. C., par. 9264 (D. C., W. D. Okla., February 23, 1961) (not otherwise reported), the government successfully argued for the proposition that where a wife had received appreciated stock from her husband as part of a property division incident to a divorce (as opposed to a transfer in discharge of her right to alimony, support, or maintenance) the wife took as her income tax basis for the stock the same basis which it had had in the hands of her former husband. There the taxpayer argued that the *Mesta* and *Halliwell* decisions required that she receive a stepped-up basis. However, the government contended that these decisions were not in point because the wife in the *Swanson* case received the stock in question as part of a division of property and not in discharge of a support and maintenance obligation as in the *Mesta* and *Halliwell* cases. See pages 5-8 of the government's brief in the *Swanson* case.

The instant case is in the same class with the *Swanson* case rather than with the *Mesta* and *Halliwell* cases. In the *Swanson* case, the government saw the distinction and used it to successfully assert that the wife did not get a stepped-up basis. There is no acceptable reason why the government should here and now change its position and contend that for purposes of taxing a husband there is no distinction between a transfer ~~and~~ in discharge of a support obligation and a transfer in division of property.

Analogous distinctions exist in other areas of the income tax law. Where a corporation declares a dividend of a fixed dollar amount and satisfies that obligation by distributing appreciated property to its shareholders, the corporation thereby realizes a taxable gain. See *Bacon-McMillan Veneer Company*, 20 B. T. A. 556 (1930); *Callanan Road Improvement Company*, 12 B. T. A. 1109 (1928), Acq. VII-2 C. B. 7 and A. R. R. 435, 4 C. B. 27 (1921). In contrast, where a corporation declares a dividend in

terms of specific property, this Court has held that the distribution does not result in the corporation having a realized taxable gain. *General Utilities and Operating Company v. Helvering*, 296 U. S. 200 (1935).

The Commissioner of Internal Revenue has recognized an analogous distinction by his rulings to the effect that where a decedent's estate distributes property to a residuary beneficiary it realizes no taxable gain even though the property distributed has a value in excess of its tax basis on the date of distribution; whereas, a decedent's estate has taxable gain when it distributes appreciated property in discharge of a fixed pecuniary legacy. Rev. Rul. 55-117, 1955-1 C. B. 233 and Rev. Rul. 56-270, 1956-1 C. B. 325.

**The Decision of the Court of Claims Will Not Result in an Escape From Income Taxation of the Appreciation in Value of the Transferred Property.**

At pages 6 and 7 of the petition the government cites *Farid-Es-Sultaneh v. Commissioner*, 160 F. (2d) 812 (2nd Cir., 1947), and *Commissioner v. Patino*, 186 F. (2d) 962 (4th Cir., 1950), for the proposition that the wife of the taxpayer in the instant case will take as her income tax basis for the property in question the fair market value of the property as of the date of her acquisition of it. The petition then goes on to state:

> "* * * If this is so, the view adopted by the Court of Claims would lead to the result that the taxpayer-husband avoids taxation on the appreciation which took place during his holding period while his taxpayer wife none-the-less obtains a 'stepped up' basis. Taxation of the gain is thus not merely deferred; it is eliminated."

The *Farid-Es-Sultaneh* and the *Patino* cases do not support the proposition that the transferee wife of the instant taxpayer will secure a basis equal to the fair market value of the property as of the date of its transfer to her.

The two cited cases involve factual situations vastly different from that in the instant case. In the *Farid-Es-Sultaneh* case the property in question was transferred to the taxpayer in advance of her marriage in consideration *inter alia* of her agreement to marry the transferor. The Court of Appeals for the Second Circuit decided that the agreement to marry was a valuable consideration which took the transfer out of the classification of a gift for basis purposes. In the *Patino* case the property in question was transferred to an estranged wife in discharge of a prior fixed dollar commitment of the husband for the support and maintenance of the transferee.

In contending that even though the husband realizes no taxable gain on the transfer of property—the wife secures a stepped-up basis, the government is ignoring its own victories in this very area. The most recent striking example of the government's ability to avoid the result suggested is found in the companion cases of *Marshman v. Commissioner*, 279 F. (2d) 27 (6th Cir., 1960) *cert. den.* 364 U. S. 918 (December 12, 1960), and *Estate of Gordon Stouffer v. Commissioner*, 279 F. (2d) 27 (6th Cir., 1960) *cert. den.* 364 U. S. 918 (December 12, 1960). The *Marshman* case involved the question of the tax basis of property transferred to a wife incident to a marital settlement. The case of *Estate of Gordon Stouffer* involved the issue of whether the transferor-husband realized taxable gain on account of the same transaction. The *Marshman* and *Stouffer* cases were tried in the Tax Court and considered in the Court of Appeals as companion cases. The Tax Court held that the husband realized taxable gain and, consistent with that result, held that the wife secured a stepped-up basis equal to the value of the property on the date of the transfer.[2] The Court of Appeals for the Sixth Circuit held that the husband realized no taxable gain on account of the transfer and, as a compliment to that result, also held that the wife

2. *Estate of Stouffer,* 30 T. C. 1244 (1958) and *Homer and Ina Marshman,* 31 T. C. 269 (1958).

did not secure a stepped-up basis. The wife filed a petition for a writ of certiorari (October Term, 1960, No. 366). The government filed a memorandum indicating that it did not seriously oppose the grant of the writ. At the same time the government filed a petition for a writ of certiorari in the husband's case (October Term, 1960, No. 512). At page 5 of its petition, the government stated:

> "As is evident, the case involving the decedent husband (Gordon) and the case involving the former wife (Ina Mae) are reciprocally related. If Gordon had a taxable gain (the holding of the Tax Court), Ina Mae's basis in the stock was, *pro tanto,* increased. If Gordon did not have a taxable gain (the holding of the Court of Appeals), Ina Mae's basis was substantially lessened and her tax liabilities, upon subsequent sale of Stouffer stock, materially increased. As already observed, the tax liabilities of both were litigated below and the former wife has now petitioned for a writ of certiorari. If the petition in No. 366 should be granted and the former wife should ultimately prevail, it will be established, by the same token, that the Government properly asserted a deficiency against Gordon. * * *"

Thus, in the *Marshman* and *Stouffer* cases the government recognized that if the husband realizes no taxable gain on a transfer, it follows that the wife takes as her basis for the transferred property the husband's income tax basis. Accordingly, there is no reasonable basis for the fear that a holding for the husband will result in taxation of the gain being "eliminated."

The result reached in the *Marshman, Stouffer,* and *Swanson* cases and in the instant case, *i.e.,* not taxing the husband on a theoretical gain at the time of the transfer of property, coupled with the complimentary rule of imposing a tax on the gain if any realized at the time the wife later sells the property results in no ultimate loss of revenue and

is entirely consonant with reasonable and workable rules of income taxation.

If in situations of this kind a gain is to be recognized either at a time when the husband transfers property to his wife or when the wife later sells the property, it seems far preferable to impose the tax in the second event rather than at the time of the transfer from the husband. At the time the husband transfers the property he is depleting his estate and is realizing no cash which will furnish a fund from which an income tax can be paid. On the other hand, if the tax is imposed at the time the wife sells the property, the tax will be imposed at a time when the taxpayer has realized a cash gain which will furnish the funds for payment of the tax. This seems to be the better result.

## CONCLUSION.

There is no real conflict between the decision in this case and the decision in the *Mesta* and *Halliwell* cases. The result reached in this case is fair to the taxpayers and the government. The petition should accordingly be denied.

Respectfully submitted,

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# In the Supreme Court of the United States

OCTOBER TERM, 1961

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No. 190

UNITED STATES, PETITIONER

*v.*

THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

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## REPLY BRIEF FOR THE UNITED STATES

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1. Respondents expressly agree that the decision below would be in direct conflict with those of the Second and Third Circuits in the *Halliwell* and *Mesta* cases if Mr. Davis had transferred the stock to his wife "in discharge of his obligation to support and maintain her" (Br. in Opp. 4). They deny, however, that the transfer here was made in discharge of such obligations and seek to liken the case, instead, to *Swanson* v. *Wiseman* (W.D. Okla.), decided February 23, 1961 (61-1 U.S.T.C. ¶ 9264). The asserted distinction does not exist.

In *Swanson,* the court found on the facts that the "distribution of the stock under the divorce decree constituted a division of jointly acquired property

and did not constitute a taxable transfer of the husband's separate property to the [wife] in satisfaction of her marital rights" (Concl. of Law No. 3). In this case, in contrast, there is no claim that the property was jointly owned and the Court of Claims expressly found that all the property "was owned by Mr. Davis subject only to the marital rights of Mrs. Davis" (Pet. 23). It was only by virtue of those marital rights that Mrs. Davis had any claim to a share of Mr. Davis' property and it was solely because of, and in satisfaction of, those rights that the transfer here was made.[1] That the transfer was in exchange for a release of marital rights was, moreover, the very premise of the Court of Claims' decision that no gain was realized because those rights could not be valued. That decision, in turn, as the Court of Claims recognized (Pet. 17), cannot be reconciled with the contrary decisions, on "almost identical" facts, in the *Mesta* and *Halliwell* cases.

[1] We fail to perceive the significance of the fact, emphasized by respondents (Br. in Opp. 2), that the periodic payments and the property transfers were, as they customarily are, provided for in separate provisions of the agreement. Property settlements and continuing periodic payments are but alternative methods of satisfying the same obligations arising from the marital relationship. And just as the periodic-payment provisions recited that the payments were in discharge of all claims for "maintenance and support" (Pet. 25), so the property settlement provisions recited that the transfers were "in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which [the wife] ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise" (Pet. 26).

2. We agree with respondents (Br. in Opp. 6–9) that the basis of the property in the wife's hands (for purposes of determining gain or loss upon a subsequent disposition of the property by her) should be a corollary to the recognition or nonrecognition of gain by the husband upon the transfer. See *Estate of Stouffer* v. *Commissioner* and *Commissioner* v. *Marshman,* 279 F. 2d 27 (C.A. 6), certiorari denied, 364 U.S. 918. That does not, however, remove the risk of inconsistent results when the husband's case and the wife's case arise in different forums. In particular, the husband might avoid tax on the appreciation in value at the date of the transfer by bringing suit in the Court of Claims—a forum open to all taxpayers—while the wife might similarly avoid tax on that appreciation when she later sells the property by bringing suit in a circuit which takes a different view of the matter and allows the wife a basis equal to the fair market value of the property at the date of the transfer.[2] Thus to prevent that element of

[2] Respondents would distinguish the cases allowing the wife a fair market value basis (*Farid-Es-Sultaneh* v. *Commissioner*, 160 F. 2d 812 (C.A. 2); *Commissioner* v. *Patino*, 186 F. 2d 962 (C.A. 4)) on the ground that they involved transfers for a consideration (Br. in Opp. 6–7). As we have shown, however, the transfer here, being in exchange for the relinquishment of marital rights, was equally made for a valuable consideration. In addition, of course, the implication of the decisions of the Second and Third Circuits in *Halliwell* and *Mesta* holding the husband to be taxable on the transfer is that those courts would hold the wife to be entitled to a fair market value basis.

appreciation from escaping taxation altogether, it is essential that the conflict be resolved.

Respectfully submitted.

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SEPTEMBER 1961.

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Nos. 190 and 268

# In the Supreme Court of the United States

October Term, 1961

United States, petitioner

v.

Thomas Crawley Davis, et al.

Thomas Crawley Davis, et al., petitioners

v.

United States

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

## BRIEF FOR THE UNITED STATES

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Statutes—Continued

# In the Supreme Court of the United States

OCTOBER TERM, 1961

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No. 190

UNITED STATES, PETITIONER

*v.*

THOMAS CRAWLEY DAVIS, ET AL.

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No. 268

THOMAS CRAWLEY DAVIS, ET AL., PETITIONERS

*v.*

UNITED STATES

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*ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

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## BRIEF FOR THE UNITED STATES

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### OPINION BELOW

The opinion of the Court of Claims (R. 100–123) is reported at 287 F. 2d 168.

### JURISDICTION

The judgment was entered on March 1, 1961. (R. 123.) By order of the Chief Justice, dated May 23,

1961, the time for filing a petition for a writ of certiorari in No. 190 was extended to and including June 29, 1961. (R. 124.) On June 1, 1961, the Chief Justice extended the time for filing a petition for a writ of certiorari in No. 268 to and including July 29, 1961. (R. 125.) The petition for writ of certiorari in No. 190 was filed on June 29, 1961, and the petition for writ of certiorari in No. 268 was filed on July 28, 1961. This Court granted the petitions on October 9, 1961, and ordered the cases to be consolidated. The jurisdiction of this Court rests on 28 U.S.C. Section 1255.

## QUESTIONS PRESENTED

1. Whether a husband realizes taxable gain when he transfers to his divorced wife, in return for the release of her marital claims, assets which have appreciated in value during his ownership (No. 190).

2. Whether legal fees paid by a husband to his wife's attorney for advice given to her about the tax consequences of a proposed property settlement agreement are deductible by him under § 212(3) of the Internal Revenue Code of 1954 as "ordinary and necessary expenses paid or incurred * * * in connection with the determination, collection, or refund of any tax" (No. 268).

## STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are §§ 61(a), 212(3), 1001, and 1002 of the Internal Revenue Code of 1954; §§ 12–901 and 13–1531 of the Delaware Code Annotated; and §§ 1.212–1, 1.1001–1, and 1.1002–1 of the Treasury Regulations on Income Tax (1954

Code). These are set forth in the Appendix, *infra*, pp. 51–56.

## STATEMENT

The material facts, as found by the Court of Claims (R. 111–123), may be summarized as follows:

### ISSUE 1 (NO. 190)

On November 4, 1954, Thomas Crawley Davis ("the taxpayer") and his former wife, Alice M. Davis,[1] executed a formal property settlement and separation agreement. The agreement was negotiated by lawyers for the two principals after extended bargaining. (R. 115–117.) The agreement recited that (R. 117)—

> the parties hereto intend by this agreement to settle their respective rights and obligations against and to one another by (1) making a division of their property; (2) providing in lieu of alimony in the event of a decree of divorce for the support and maintenance of the wife; (3) making an arrangement and provision for the support and maintenance of Stephen; and (4) defining the rights of custody, maintenance, support and education of their minor child.

All of the property involved in the settlement negotiations was owned by Mr. Davis subject only to the marital rights of Mrs. Davis under Delaware law. (R. 115.)

As a "division in settlement of their property" the taxpayer agreed, *inter alia*, to transfer to Alice M.

[1] Respondent Grace Ethel Davis is taxpayer's present wife. She is a party to this proceeding only because she and her husband filed a joint tax return in 1955.

Davis 1,000 shares of duPont stock, 500 shares to be delivered by April 1, 1955, and 500 shares by April 1, 1956. (R. 117.) Mrs. Davis, on her part, agreed to accept (R. 117–118)—

> the division of property herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise.

The parties further agreed (R. 97)—

> The parties hereto and each of them covenant that this agreement is and shall be a complete and final settlement of all claims of every nature and kind between them. Upon performance of husband's covenants and undertakings under this agreement, the wife hereby waives, releases and relinquishes unto the husband all rights that she might otherwise have to any of the property of the husband and to any claim for support or maintenance for herself and their minor child * * *.

The agreement provided that in the event a decree of divorce should be granted "such decree shall in no way effect the obligations of either of the parties hereunder" and that the provisions of the agreement might, but need not, be incorporated into such decree, subject to the approval of the court granting such divorce. (R. 98, 118.) Other provisions of the agreement, not material here, provided for the disposition of other properties (house, automobile, and insurance

policies), periodic payments to the wife "for her maintenance and support," and the creation of a trust for the support of the child. (R. 117–118.)

On January 5, 1955, Alice M. Davis was granted a final decree of divorce from Mr. Davis by the Second Judicial District Court of the State of Nevada. The court's decree approved the settlement agreement of the parties and directed them to carry it out. (R. 111.)

On March 21, 1955, taxpayer, pursuant to the agreement, transferred to Mrs. Davis 500 shares of du Pont common stock. His cost basis in these shares was $74,775.37 and their fair market value at the time of the transfer was $82,250. (R. 121, 122.) The Commissioner determined an income tax deficiency for 1955 on the ground that Mr. Davis realized a taxable gain of $7,474.63, the difference between the two figures. (R. 100.) Overruling the Commissioner's determination, the Court of Claims held that (R. 109–110), although the taxpayer may have realized economic gain, he did not realize taxable gain under the provisions of § 1001(a) of the 1954 Code. The Court reasoned that (R. 109) the statutory definition of "amount realized" calls for a determination of "fair market value of the property * * * *received*" and that there were no adequate criteria for measuring the value of the marital rights released by Alice M. Davis.

ISSUE 2 (NO. 268)

Shortly prior to June 15, 1954, about five and one-half months before the execution of the separation and property settlement agreement, taxpayer's wife, Alice M. Davis, consulted an attorney, James R. Morford,

with respect to her marital difficulties and obtaining a property settlement. Taxpayer, that summer, retained H. Albert Young as counsel to represent him in the matter. These attorneys negotiated the separation and property settlement but did not act for their clients in connection with the divorce suit in Nevada, which was independently handled by a Nevada law firm. (R. 115, 119.)

Throughout the subsequent negotiations in relation to the separation and property settlement agreement, both Mr. Young and Mr. Morford considered the Federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client. (R. 119.)

During the negotiations, Mr. Morford and Mr. Young advised taxpayer that it was the practice, in conformity with Delaware law, that the husband pay the attorneys' fees of both parties in connection with negotiations for a separation and property settlement agreement. As a result, although this agreement was not incorporated in the separation and property settlement agreement, taxpayer paid his wife's attorney (Mr. Morford) fees totalling $10,000 in addition to his own attorneys' fees totalling $12,506. (R. 120.)

In each instance the fee was based on two separate bills received by taxpayer from the respective attorney. One was for services relative to the separation agreement and property division, for which Mr. Young charged $7,506 and Mr. Morford $5,000. The other bill, as rendered by Mr. Young, was for services

"Re: Tax matters in the case of Davis v. Davis" and, as rendered by Mr. Morford, "To professional services rendered in connection with tax matters involved in the matter of Alice M. Davis versus T. Crawley Davis". For these services Mr. Young charged $5,000 and Mr. Morford $5,000. Taxpayer made partial payments on the various bills in 1954 and paid the remainder in early 1955, $5,000 of which was on the bills for tax advice ($2,500 as to each attorney). (R. 120.)

Mr. Morford testified that he allocated his total fee into the two categories, the property settlement and tax advice, at the request of the taxpayer and that he could not possibly segregate his fee in such a manner and justify the amount of one bill as against the other. However, he testified that tax problems "underlaid the whole relationship of the parties" and that he believed that the allocation of the fee, as carried out at the request of taxpayer, appeared to be entirely reasonable.[2] (R. 120–121.)

In his 1955 tax return, taxpayer claimed a deduction for legal fees in the amount of $5,000, composed of the $2,500 payments made to each attorney for tax advice in connection with the separation and property settlement agreement. The Commissioner disallowed the claimed deduction and taxpayer subsequently paid

[2] As to Mr. Young, taxpayer's attorney, the court below noted (R. 121) that "in his appearance as a witness in this case, Mr. Young's testimony was vague and general as to the reasonableness and propriety of the division of his overall fee into the two categories, and he did not state whether the segregation was made by him independently or at the suggestion of Mr. Davis."

the resulting deficiency and filed a proper claim for refund. (R. 121, 122.) This suit for refund followed.[3]

The Court of Claims held that taxpayer was entitled to deduct the attorneys' fees he paid to his own attorney, Mr. Young, for his services in regard to tax matters but that he was not entitled to deduct the fees he paid to his wife's attorney, Mr. Morford, for the same type of service to the wife. (R. 103–104.)

## SUMMARY OF ARGUMENT

### I

A. The first question in this case is whether the taxpayer-husband realized a taxable gain upon the transfer to his wife, pursuant to a divorce settlement, of appreciated property in exchange for a release of her marital rights. The gain upon such a transfer has been held to be taxable by the Third and Second Circuits, in the *Mesta* and *Halliwell* cases, and to be nontaxable by the Sixth Circuit, in the *Marshman* case. In this case, the Court of Claims, following the *Marshman* case and rejecting the *Mesta* and *Halliwell* decisions, held that the gain was not taxable.

The resolution of that issue turns upon two distinct questions. The first is whether a property settlement

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[3] In his claim for refund taxpayer also claimed a deduction for the remainder of the attorneys' fees paid to the two attorneys in 1955, which were for services in negotiating the separation and property settlement agreement. (R. 122.) This issue is not before this Court, since the Court of Claims denied the deduction and taxpayer did not petition on that issue. A similar issue is, however, before this Court in two other pending cases, *United States* v. *Gilmore* (No. 255, October Term, 1961), and *United States* v. *Patrick* (No. 256, October Term, 1961).

incident to a divorce should be treated as a taxable event at all—*i.e.,* whether it is the kind of "sale or other disposition of property" in which an accounting for gain or loss is required. The second is whether, assuming that it is a taxable event, the gain can be measured by the value of the property transferred, presuming that value to be equal to the value of the wife's rights given up in exchange. Like the Sixth Circuit in the *Marshman* case, the Court of Claims in this case seems not to have questioned that the transaction was in kind a taxable event, basing its decision, rather, solely on the ground that there was no way to measure the gain. In our view, however, the crucial question in the case is the initial one whether the transaction should be treated as a taxable event and it is with that question that we will first deal.

B. Marital property settlements being *sui generis,* their characterization for tax purposes poses an admittedly perplexing question. There are, however, two alternative categories of transactions to which they might be likened, and the choice between them is, we believe, the question upon which the decision in this case should turn.

The first category, in which we contend the transaction here should be placed, consists of transfers in discharge of an indebtedness. Transfers of property to satisfy a liquidated money obligation are admittedly deemed to be taxable exchanges, and the fact that the claim discharged has not previously been reduced to a liquidated dollar amount is plainly not in itself a difference in kind (though it might raise the measurement question discussed

below). A transfer of property in satisfaction of a tort claim for personal injuries, for example, would clearly be a taxable event. It cannot be denied, however, that there are differences, in shading at least if not in nature, between obligations of that sort and those of the wife discharged by the property settlement here. A tort obligation, for example, arises and is measured independently of what is owned by, and represents merely a "creditor's" claim against, the tortfeasor. Under Delaware law, however, the wife's rights upon divorce are defined primarily by a statute directing the divorce court to award to her "such share" of the husband's estate as the court deems "reasonable." There is, therefore, at least the difference that her rights are measured, not independently, but by what the husband has. Yet that measurement of what the wife is entitled to receive hardly converts what is otherwise but a personal liability of the husband for maintenance and support into a "property" or "equity" interest in the husband's property itself. Thus, while recognizing that there are differences between a wife's marital rights and other "independent" obligations, we do not believe the differences are sufficient to justify excepting transfers of property in discharge of such rights from the general principle that a transfer of property for a release of a legal obligation is to be treated as a taxable "exchange." That is the characterization of transfers in discharge of marital rights that has been uniformly followed by the lower courts, and it is, we submit, the sounder view of such transactions.

The analogy to which petitioner contends divorce settlements should be likened is that of a "division" of property among persons having a pre-existing right to "share" in it. Examples of transactions which are deemed to be nontaxable "divisions" rather than taxable "exchanges" include divisions in kind of jointly-owned or community property, of partnership assets among the partners, and of the assets of a trust or estate among those beneficially entitled to a "share" of the corpus (as distinguished, *e.g.*, from a legatee entitled to a fixed dollar amount). In all of those cases, however, the recipient has a recognized "property" interest in the assets being divided, which a wife in a common-law state plainly does not have. The fact that the allowance to a divorced wife, under the Delaware statute, is measured by "such share" of the husband's property as the court deems "reasonable" does, we acknowledge, give to a property settlement satisfying that right something of the flavor of a "division" of property. To that extent, and since state concepts of "property" are not necessarily controlling for tax purposes, it might not have been unreasonable as an original matter to have likened marital settlements, notwithstanding the conceptual differences, to a "division" of property. Yet property concepts are important for tax purposes, and we do not believe that the "division" cases should be extended beyond transactions involving recognized "property" interests. At the very least, the consistent rejection by the lower courts, over a period of twenty years, of that characterization of marital settlements in favor of treating them as taxable "ex-

changes" of property for a release of legal obligations is a permissible resolution of the question and ought not now be upset.

C. Respondent alternatively contended in the court below that property settlements should be treated as "gifts", on the premise that marital obligations, voluntarily assumed in a transaction (the marriage) springing out of purely personal motivations, ought not be given any greater significance as "consideration" for income tax purposes than they have traditionally been given for gift and estate tax purposes. Whatever might have been said for that characterization were it an open question, that treatment of such transfers is, we believe, foreclosed by this Court's decision in *Harris* v. *Commissioner,* 340 U.S. 106.

D. Assuming that property settlements incident to a divorce are to be treated as taxable "exchanges" of property in satisfaction of legal obligations, there remains the question of measurement of the gain. It was on that ground that the Court of Claims' decision was based, the court holding that, while there was a taxable "exchange", there was no way to measure the value of what was "received" and thus no way to compute the gain. There is, however, more than ample authority for measuring what is received in an exchange, in the absence of other evidence, by the value of what is given. That amounts simply to a presumption that the values of properties exchanged in an arm's-length transaction are equal—a presumption generally in accord with common experience and in any event justified by

necessity. Having concluded that the transaction is of the kind that Congress intended to tax, it is surely preferable to adopt a measure of the gain at least approximat~~ely~~ing the result intended rather than to defeat the purpose altogether.

In our view, the inability-to-measure ground of the Court of Claims' decision, which among other things will produce an inconsistent basis consequence to the wife, is not a permissible solution to the problem presented by marital settlements. They should either be held not to be taxable "exchanges" at all—*e.g.*, on the "division" of property analogy, which we concede to be at least a permissible characterization—or, if held to be taxable, the best measure of the gain available should be adopted. The deficiencies, if any, in the tools for measurement of the gain are at most considerations to be taken into account in deciding whether to treat such transfers as taxable events. They should not lead to the anomaly—and anomalous consequences—of treating the transaction as taxable in theory but not in practice.

## II

The court below properly denied the taxpayer a deduction for his payment of attorneys' fees incurred by his wife for advice as to the tax consequences of the various proposals made in connection with the separation and property settlement agreement. The deduction provision relied upon by taxpayer does not permit the deduction of legal fees for such tax advice and, even if it did, taxpayer would not be entitled to a deduction for his wife's expenses.

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Section 212(3) of the Internal Revenue Code of 1954, under which the deduction is claimed, allows a deduction only for the ordinary and necessary expenses paid "in connection with the determination, collection, or refund of any tax." This language and the legislative history of the provision show clearly that Congress intended to allow a deduction for tax advice only in connection with the computation or contesting of accrued tax liability.

Even if § 212(3) were construed so broadly as to allow a deduction for expenses incurred for advice on the tax aspects of prospective transactions, taxpayer would not be entitled to the claimed deduction for the fees paid his wife's attorney. As the court below explained, the fees were incurred by the wife for tax advice as to her own tax problems, not taxpayer's. Accordingly, the wife's fees were not, as to taxpayer, an expense paid for tax advice. Their payment by him was merely a part of his settlement with his wife, made by him because under Delaware practice it is customary for the husband to pay the attorneys' fees which the wife incurs in connection with a separation and property settlement agreement.

## ARGUMENT

### I

### THE TAXPAYER'S TRANSFER OF APPRECIATED PROPERTY TO HIS WIFE IN EXCHANGE FOR A RELEASE OF HER MARITAL CLAIMS RESULTED IN A REALIZATION OF TAXABLE GAIN

#### A. INTRODUCTION

1. Pursuant to a property settlement agreement, the taxpayer transferred to his wife [4] shares of stock that had appreciated in value over the taxpayer's cost basis for them. In exchange the wife, by the agreement, accepted the stock in full satisfaction of all of her rights against the taxpayer arising out of the marriage. The question is whether the husband, by the use of his appreciated stock to satisfy his legal obligations to his wife, realized a taxable gain on the transaction equal to the excess of the value of the stock over his basis.

A collateral question, not directly involved in this case but important to a consideration of the problem it poses, is the basis the stock will have in the hands of the wife. If the husband is taxed on the gain, then the wife should receive a basis for the property equal to its fair market value so that, if she subsequently disposes of the property, she will not be taxed on the same gain. Contrariwise, if the husband is not taxed on the gain, the wife should take the stock with the same basis it had in the husband's hands so that the gain does not escape taxation entirely. By

[4] "Husband" and "wife" are used in this brief to include divorced spouses.

and large, the two consequences are corollaries, and the incident found determinative of the recognition of gain by the husband will also control the wife's basis. Thus the effect on the wife's basis is an important consideration in determining how the transaction should be treated for purposes of the husband's recognition of gain.

The Tax Court originally held that a husband did not realize taxable gain upon a transfer of appreciated property to his wife in discharge of marital obligations. However, the Third Circuit in 1941, followed by the Second Circuit in 1942, held that the husband did have taxable gain. *Commissioner* v. *Mesta,* 123 F. 2d 986 (C.A. 3), reversing 42 B.T.A. 933, certiorari denied, 316 U.S. 695; *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C.A. 2), reversing 44 B.T.A. 740, certiorari denied, 319 U.S. 741. The Tax Court in due course accepted those decisions, applying them to give the wife a "cost" basis for property received in a property settlement equal to the fair market value of the property. *Hall* v. *Commissioner,* 9 T.C. 53.[5] The Second and Fourth Circuits have applied substantially the same principles to give a wife a fair market value basis for property received by her in

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[5] In that case, the parties to the agreement had themselves placed a dollar valuation on the property that the wife was to receive, and the Tax Court used that valuation as the parties' measure of the value of the wife's rights, without determining whether the true fair market value of the property transferred differed from their valuation. That distinction is not important here, where the parties did not put a valuation on the property. See *Marshman* v. *Commissioner*, 31 T.C. 269, reversed, 279 F. 2d 27 (C.A. 6).

exchange for a release of marital rights by an antenuptial agreement (*Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812 (C.A. 2)) or by an agreement made during coverture (*Commissioner* v. *Patino,* 186 F. 2d 962 (C.A. 4)).

The Sixth Circuit, however, rejected the *Mesta* and *Halliwell* decisions and held that a transfer of appreciated property to a wife pursuant to a divorce settlement resulted neither in a taxable gain to the husband nor, consistently, a fair market value basis in the wife. *Commissioner* v. *Marshman* (consolidated with *Estate of Stouffer* v. *Commissioner*), 279 F. 2d 27 (C.A. 6), certiorari denied, 364 U.S. 918. In this case, the Court of Claims has now sided with the Sixth Circuit in holding that the husband realizes no taxable gain in such a transaction. It was to resolve that conflict that the case was brought here.

2. The statutory framework of the question is simple. Section 61(a) of the Internal Revenue Code of 1954 [6] defines gross income as meaning "all income from whatever source derived, including (but not limited to) * * * (3) Gains derived from dealings in property." Section 1001 provides that:

> (a) The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis * * *.
>
> (b) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value

[6] Unless otherwise indicated, all section references in this brief are to the 1954 Code.

of the property (other than money) received.
* * *

Applying the settled principle that the satisfaction of a legal obligation (*e.g.*, the discharge of a debt) is a receipt to the obligor, the courts in the *Mesta* and *Halliwell* cases held that the release or discharge of the husband's legal obligations to his wife, in exchange for his transfer of property to her, was a sufficient "receipt" to make the transaction a taxable exchange under those provisions. Acknowledging the difficulty of independently valuing the marital claims released by the wife, those courts held further that the value could properly be measured by the value of the property transferred by the husband to the wife, that being presumably the value the parties put upon the wife's rights in agreeing to the settlement.

The Sixth Circuit in *Marshman* and the Court of Claims in this case did not disagree that the transaction was in nature a taxable event—*i.e.*, a "sale or other disposition" of property in exchange for a receipt of a discharge of a legal obligation. They held, however, that because of the variety of the factors influencing a divorce settlement negotiation, the value of the rights released by the wife could not properly be measured by the value of the property given by the husband, and accepted by her, in satisfaction of them. There being no other way to value those rights, there was, the courts held, no way to determine the "amount realized" by the husband and hence no way to compute the amount of his gain. In short, those courts, while seemingly agreeing that such a transaction produces a gain of the kind meant to be taxed by the statute, relieve the hus-

band from tax on that gain only because of an inability to measure its amount.

The stated ground for the decision below is not, we will show, supportable. If a transfer of appreciated property in satisfaction of marital rights is otherwise properly to be treated as a taxable event, there can be no doubt, we think, of the propriety of measuring the value of the receipt, in the absence of any other measure, by the value of the property transferred. We acknowledge, however, that the decision below, although rationalized in terms of the inability to value the receipt, may reflect an underlying conviction that a marital property settlement ought not be treated as a taxable event at all. Accordingly, before turning in the measurement-of-value question, we will deal explicitly with the question whether a transfer of property in satisfaction of marital rights is properly to be treated as a taxable exchange giving rise to a realization of gain or loss.

B. A PROPERTY SETTLEMENT SHOULD BE DEEMED A TAXABLE EVENT IN THE NATURE OF A TRANSFER OF PROPERTY IN DISCHARGE OF A DEBT RATHER THAN A NONTAXABLE "DIVISION" OF PROPERTY

As *Helvering* v. *Horst,* 311 U.S. 112, teaches, questions of realization cannot be solved by a mere parsing of the statutory language or by logical imperatives. Starting with the evident purpose of Congress, by its sweeping definition of income, to reach all "gains" or accessions to wealth (see *Commissioner* v. *Glenshaw Glass Co.,* 348 U.S. 426), the problem becomes the pragmatic one of determining what constitutes an appropriate occasion for the reckoning up by the taxpayer of the economic gains that have accrued to him. Ad-

ditionally, since marital rights and obligations are unique in their nature, the problems posed by transfers in satisfaction of them must be acknowledged to be *sui generis*. Accordingly, while on balance we believe that such a transfer provides an appropriate occasion for accounting for the husband's gain or loss on property held by him and transferred to his wife, and should be treated as a taxable event, we do not offer that conclusion as a matter of logical compulsion or as the dictate of immutable principles governing the question of realization in other areas.

There are perhaps three ways of characterizing marital settlements for tax purposes: (1) as a transfer of property in "exchange" for the release of a legal obligation; (2) as what may be called a "division of property," simply giving to the wife that "share" of the husband's estate to which she is equitably entitled; or (3) as a "gift." The government contends for the first; the respondent, primarily for the second but alternatively for the third. We shall consider here the choice between the first two alternatives, the choice primarily in dispute, and then show in the next point why we think such a transfer cannot be treated as a gift.

1. It is axiomatic, of course, that a transfer of property in satisfaction of an independent legal obligation is a taxable event upon which gain or loss is to be recognized. Thus, the use by an estate or testamentary trust of appreciated property to satisfy legacies of fixed dollar amounts (enforceable as a debt) is treated as a sale or exchange on which the estate or

trust must recognize the gain.[7] Nor is that result dependent upon the obligation being for a liquidated dollar amount; there can be no doubt, for example, that a transfer of property in settlement of a tort suit for personal injuries would be a taxable sale or exchange of the property.

On the other hand, if the transferee has a pre-existing property right to a "share" of the property itself, the partition or division of the property, and the distribution to the transferee of his share, is not generally a taxable event. That is true, for example, of the partition in kind of jointly-owned property,[8] of the division of partnership property among the partners upon dissolution,[9] or of the division of the corpus of an estate or trust and the distribution of their respective shares to legatees or trust beneficiaries.[10] That may also be the explanation in part for not treating distributions in kind by a corporation to its stockholders as a taxable event to the corporation.[11]

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[7] *Suisman* v. *Eaton*, 15 F. Supp. 113 (D. Conn.), affirmed *per curiam*, 83 F. 2d 1019 (C.A. 2), certiorari denied, 299 U.S. 573; *Kenan* v. *Commissioner*, 114 F. 2d 217 (C.A. 2). See also *Gransden & Co.* v. *Commissioner*, 117 F. 2d 80 (C.A. 6); *Warren* v. *Commissioner*, 117 F. 2d 82 (C.A. 6). For the general principle that release of an indebtedness is a receipt by the obligor, see, *e.g.*, *Commissioner* v. *Jacobson*, 336 U.S. 28.

[8] Rev. Rul. 55–77, 1955–1 Cum. Bull. 339; Rev. Rul. 55–179, 1955–1 Cum. Bull. 340; Rev. Rul. 56–437, 1956–2 Cum. Bull. 507.

[9] *Crawford* v. *Commissioner*, 39 B.T.A. 521; I.T. 2010, III–1 Cum. Bull. 46; Sol. Op. 42, 3 Cum. Bull. 61.

[10] U.S. Treas. Regs. on 1954 Code, § 1.661(a)–2(f)(1); Rev. Rul. 55–117, 1955–1 Cum. Bull. 233; O.D. 667, 3 Cum. Bull. 52; *Long* v. *Commissioner*, 35 B.T.A. 95.

[11] *General Utilities Co.* v. *Helvering*, 296 U.S. 200.

More closely in point is the division of community property between a husband and wife upon divorce, which is not deemed a sale or exchange.[12]

The property settlement here, and it seems likely in most common-law states, falls somewhere between those two polar situations. In addition to her right to support and maintenance, an undivorced wife's rights under Delaware law include dower, which she may elect in lieu of her rights under a will, and rights of intestate succession (with children surviving, one-third of the personalty and a life estate in one-half of the realty).[13] Her rights upon divorce are governed by the following provision (8 Del. Code Ann., Title 13, § 1531):

> § 1531. *Allowance or division of property upon divorce granted for aggression.* (a) When a divorce shall be decreed for the aggression of the husband, the complainant shall be * * * allowed, out of her husband's real and personal estate, such share as the court thinks reasonable * * *.
>
> (b) Any allowance or division of property under subsection (a) of this section, may be by a gross sum, or an annual allowance, or an assignment by metes and bounds. * * *

With the possible exception of the dower rights in real estate, those inchoate rights plainly do not amount to a vested property interest in the property owned by the husband and, in traditional concepts, are quite

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[12] *Swanson* v. *Wiseman* (W.D. Okla.), decided February 23, 1961 (61-1 U.S. T.C. ¶ 9264); *Walz* v. *Commissioner*, 32 B.T.A. 718.

[13] 8 Del. Code Ann., Title 12, §§ 502, 512, 901, 904, 905.

different from the "property" interests of a partner, of a trust beneficiary, or of a wife in a community-property state. On the other hand, the wife's inchoate right upon divorce to such "share" of the husband's property as the court deems "reasonable" is a claim significantly different in nature from a debt in a specific dollar amount or an unliquidated but independent liability (*e.g.,* a tort claim for personal injuries). If nothing else, it is different at least in that the wife's right is measured, not independently, but by the size of the husband's estate—with the consequence that an increase in the husband's estate through appreciation also operates to increase the amount to which the wife is entitled. And viewing the wife's rights as an inchoate right to a "fair share" of the husband's estate—not as definite in fractional terms as it is in community property states but still a recognition of the wife's right to "participate," as it were, in the husband's gains—it is not implausible to conclude that a property settlement should be analogized, despite the conceptual differences as a matter of property law, to a "division" of property rather than to a transfer in "exchange" for a release of independent personal obligations.

Since marital property settlements do not fit neatly into the mold either of an "exchange" of property in satisfaction of independent liabilities or of a "division" of property, the inevitability of one characterization or the other cannot be dogmatically asserted. Nevertheless, in our view such a transaction is more properly to be viewed as an "exchange" in

discharge of a liability. The very premise of the "division" notion is the recognition of pre-existing "property" rights, and the fact that Delaware, and probably most common-law states, deems it proper to measure the award to the wife by the size of the husband's estate seems hardly enough to convert what is otherwise but a personal liability of the husband to support his wife into a "property" interest of the wife in the husband's property. What the wife receives in a property settlement is not simply a divided part of a whole in which she had previously had an undivided interest, but rather ownership of specific property in lieu of the husband's personal liabilities to her, a conversion of the nature of her rights that can be forced into the mold of a "division" only with considerable straining. On the other hand, the differences between the husband's marital obligations and other legal liabilities, while real, is more a difference of degree than of kind. The measurement of the wife's rights by what the husband has seems ultimately little more than the use of an ability-to-pay standard to fix the amount of the husband's liability to the wife, and the satisfaction of that liability by a transfer of the husband's separate property seems not essentially different from the satisfaction of other kinds of liabilities. And, while the mere partition of, say, a tenancy-in-common may not effect a sufficient change in the nature of ownership to be a taxable event, a marital property settlement clearly does effect a quite complete conversion in the nature of the rights and liabilities of the parties, making it a fully appropriate occasion for a reckoning up of the

previously-accrued gain or loss. Accordingly, a marital property settlement should, we believe, be treated as a taxable "exchange" of property for a release of legal obligations rather than, as respondent contends, a nontaxable "division" of property.

2. We recognize, however, that an exercise in conceptual pigeonholing cannot provide the final answer to what is, after all, a very practical problem of taxation. We turn, accordingly, to a consideration of the practical implications of the choice to be made between the "exchange" and "division" characterizations of marital property settlements.

In seeking the proper tax treatment of property settlements, certainly the most important single desideratum is that the basis of the property in the wife's hands be consistent with the tax treatment of the husband, so that the appreciation will neither escape taxation altogether nor be taxed more than once. For that purpose, however, either of the solutions seems equally acceptable. If the settlement is treated as a taxable exchange of the husband's property for the wife's rights, what the husband is deemed to receive for the property is necessarily the same as what the wife is deemed to "pay" for it. Thus the wife will receive a "cost" basis for the property equal to the value at which the husband was required to account for the gain, and the appreciation will be taxed but once. If the settlement is deemed a nontaxable "division" of property, the wife will have no independent "cost" basis for the property she receives, but the very concept of a division requires that she take the property with the same basis it had in the husband's

hands. Thus the appreciation, though not then taxed, will be taxed if and when the wife disposes of the property, and no income will escape taxation.

So long as a consistent basis treatment is assured, the effect of the choice on the revenues is problematical. Theoretically, taxing the husband would produce the greater revenue, since he is likely to be in the higher bracket and the wife may never make a taxable disposition of the property.[14] On the other hand, the choice of the properties to be transferred to the wife is fully within the control of the parties, and if a tax is to be imposed, they may be expected to select those with the least appreciation, or possibly depreciated properties on which the husband could claim a loss. Additionally, there is some likelihood, for a variety of reasons, that collection of the tax will be less certain if the property settlement, rather than the wife's ultimate disposition of the property, is deemed the taxable event.[15] On bal-

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[14] If she retains the property until her death, for example, her heirs will acquire a new basis for the property equal to its fair market value at the date of her death (§ 1014(a)), and any appreciation up to that date will not be taxed.

[15] For one thing, the valuation problems are often formidable. Although the husband's gain and the wife's basis would theoretically both be measured by the same incident (the value of the property transferred), in ca s of doubtful valuations the husband could be expected to claim a low valuation on his return and the wife, perhaps many years later when she disposes of the property, a high valuation. To assure taxing the full gain would thus often require litigation of the question of value—with consistent findings—with both the husband and the wife, a hope that in practice is not likely to be realized. If, on the other hand, the wife takes the property with the husband's cost basis, the valuation problem is avoided and the full gain is more likely automatically to be reported upon the wife's later sale of the property. While the valuation problem is not peculiar to this area, it does somewhat mute

ance, the substantial likelihood that the gain would otherwise escape taxation entirely through the wife's holding the property until her death suggests that the revenues would be favored by taxing the husband upon the settlement, but we do not suggest that by itself that should be given controlling weight.

Another relevant consideration is the effect of the rule adopted upon the conduct of divorce negotiations—in which the tax consequences are of course an important factor—and the "equities" as between the husband and the wife. If the settlement is not treated as a taxable exchange, and the wife takes appreciated property with the husband's basis and later makes a taxable disposition of it, the effect is to shift the incidence of the tax from the husband to the wife, a result that may seem inequitable. On the other hand, taxing the husband upon the transfer will diminish the total property available for division, and the tax incidence can always be allowed for by adjusting the gross amount of the settlement. Here again, it would seem more important that the rule be certain so that the tax consequences may be taken into account in the negotiations than that one rule or the other be adopted.

3. With the other considerations being inconclusive, we come to the factor that, in our view, should be determinative in favor of treating the transfer as a

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the revenue implications of the decision here. In addition, taxpayers not well advised by tax counsel are perhaps likely to be less attuned to the tax consequences of a divorce settlement than to those of the wife's later sale of the property, with the consequence that a failure to report divorce-settlement "exchanges" may occur with a higher incidence than a failure to report the wife's sale.

taxable exchange, and that is the force of precedent. While, as an original matter, the choice might reasonably have gone either way, the fact is that in 1941 the Third Circuit in *Mesta,* followed a year later by the Second Circuit in *Halliwell,* adopted the view that a divorce settlement should be treated as a taxable transfer in satisfaction of a legal obligation. The Tax Court, which had been reversed in those cases, made clear its acquiescence at least by 1947 in its decision, reviewed by the full court, in *Hall* v. *Commissioner,* 9 T.C. 53. And in 1947 and 1950, the Second and Fourth Circuits applied the principle that a release of marital rights is a taxable exchange to property agreements made before and during marriage. *Farid-Es-Sultaneh* v. *Commissioner, supra* and *Commissioner* v. *Patino, supra.* That seemingly settled state of the law remained undisturbed until 1960, when the Sixth Circuit, in the *Marshman* case, rejected the *Mesta-Halliwell* principle and held the husband not taxable. Moreover, neither the Sixth Circuit in *Marshman* nor the Court of Claims in this case in terms rejected the view that a property settlement was in nature a taxable exchange, basing their decisions rather on the valuation ground discussed below.

There has thus been for many years substantial agreement among the lower courts on the principle that divorce settlements are to be treated as being taxable dispositions of property in exchange for a release from a legal obligation. And even if the decisions in *Marshman* and in this case be deemed a departure from that principle, though in terms based

on a different ground, the law was apparently taken as settled at least for the 19-year period intervening between the *Mesta* and *Marshman* decisions. The degree to which the parties to divorce settlements relied, during that period, upon the *Mesta-Halliwell* principle in negotiating their agreements can of course only be speculated. Even without demonstrable reliance, however, the principles that have become established in the lower courts ought to be accepted here in the absence of strong reasons for overturning them.

In short, even if as an original matter a divorce settlement might as readily be viewed as a "division" of property as an "exchange" in satisfaction of a legal obligation, the lower courts (including the Sixth Circuit and the Court of Claims, in principle) have unanimously adopted the latter view. The considerations pro and con being at best evenly balanced, that settled principle should not now be overturned.

C. A PROPERTY SETTLEMENT CANNOT QUALIFY AS A GIFT

Respondent alternatively argued in the Court of Claims that the transfer here should be treated as a "gift." That treatment would invoke the basis provision giving to property acquired "by gift" the same basis in the hands of the donee (for purposes of determining gain) as it had in the hands of the donor (§ 1015) and the settled principle (in part an implication drawn from the basis provision) that no gain is realized upon a gift of appreciated property.

Notwithstanding the seeming anomaly of treating as a "gift" a transfer made under legal compulsion—*i.e.*, to satisfy a legal obligation—we acknowledge that,

as an original matter, that might well have been the most satisfactory treatment of such marital transfers. The estate and gift tax provisions, generally applicable to transfers made without "an adequate and full consideration in money or money's worth" (*e.g.*, §§ 2036 (a), 2512(b)), have long been qualified by a general provision that a release of dower or "other marital rights" in a husband's property does not qualify as consideration (§ 2043(b)).[16] Thus the general rule is that transfers to a wife in exchange for her release of marital rights (*e.g.*, by an antenuptial agreement or agreement during coverture) are subject to the gift tax and, if certain interests are retained (*e.g.*, a life estate), to the estate tax. And similarly, of course, the wife's statutory share of a decedent's estate is includible in his estate for estate tax purposes (though now subject to the marital deduction) notwithstanding that she takes against the will and on the basis of a legal right given her by state law (§ 2034).

Those provisions reflect a basic Congressional judgment that marital rights and obligations—themselves voluntarily created and assumed in a transaction, the marriage, entered into for the most personal of reasons—ought not be treated as "commercial" obligations the satisfaction of which is removed from the reach of the transfer taxes (the gift and estate taxes) otherwise governing intra-family transfers. It is true that the gift tax and the income tax are not *in pari materia* and that a transaction need not be given the

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[16] The provision actually appears only in the estate tax provisions. The same limitation was read into the gift tax provisions, however, in *Merrill* v. *Fahs*, 324 U.S. 308.

same characterization for both purposes, but it might well have produced a more consistent structure as a whole to have treated all marital transfers—whether or not expressly in discharge of marital rights—as governed exclusively by the gift and estate taxes and not as income-taxable exchanges. Cf. Clark, J., dissenting in *Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812, 815–816 (C.A. 2).[17]

The difficulty with that argument, however, is that the property settlement here was in fact not subject to the gift tax. While a transfer of property to a wife in exchange for a release of her marital rights is subject to the gift tax if made either before marriage, in an antenuptial agreement, or during coverture (*e.g.,* incident to an informal separation), it is not if made under a settlement agreement entered into within two years of a divorce. The origin of that exception is the decision in *Harris* v. *Commissioner,* 340 U.S. 106. There the Court, reasoning that the provision of the 1939 Code treating a release of marital rights as not adequate consideration was applicable only to transfers under agreements and not to those under a di-

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[17] The rationalization might be that a transfer in discharge of a legal obligation is a gift if the obligation itself was created by way of a gift transaction. The clearest example is a transfer to charity to satisfy a legally-enforceable pledge previously made. Another example might be the transfer to a son of property that was promised him should he refrain from smoking until he became of age (assuming the promise was an enforceable contract under state law). From those examples, it is a not impossible leap to conclude that a transfer to a wife to satisfy obligations voluntarily assumed, out of love and affection, at the time of marriage can reasonably be characterized as a "gift" for income tax purposes.

vorce *decree*, held that a transfer made pursuant to a court decree (though adopting a settlement agreement submitted by the parties) was not subject to the gift tax. There followed considerable litigation over the question whether a particular transfer provided for in an agreement was made pursuant to the agreement or pursuant to the decree approving it. To pretermit that area of controversy, Congress in the 1954 Code added the provision excepting from the gift tax all transfers pursuant to a property settlement agreement entered into within two years of a divorce (§ 2516).

Since that provision is applicable to the transfer here, it removes the very basis for an argument that the transfer should be treated as a "gift" for income tax purposes—namely, the desirability, if not necessity, of correlating the income and gift tax treatment of the transaction. Additionally, the premise of the *Harris* decision is that a transfer in exchange for a release of marital rights is not intrinsically of the nature of a "gift" and could be made so, if at all, only by an express provision directing that the release of such rights be ignored. Since no such provision can be found in the income tax statute, the transfer here can no more qualify as a "gift" under that statute than could the transfer in *Harris* qualify as a "gift" under the gift tax statute after the Court found that the explicit marital-rights provision there was inapplicable.[18]

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[18] Nor can the implications of *Harris* for income tax purposes be limited to transfers pursuant to a decree as distinguished from those pursuant to an agreement. That distinction was relevant in *Harris* only to determine the applicability of the express provision (now § 2043(b)) making a release of marital

It may be acknowledged that the *Mesta-Halliwell* principle that a transfer in exchange for a release of marital rights is a taxable exchange on which gain or loss is to be recognized produces what appears to be, at first sight, an anomalous consequence—namely, that in certain circumstances a single transfer may be deemed to be a taxable "sale or exchange" for income tax purposes and yet a "gift" for gift tax purposes, so that the husband is liable both for income taxes on the realized gain and for gift taxes on the gift. That would be true, in fact, of any such transfer pursuant to an agreement executed other than within two years of a divorce (*e.g.*, an antenuptial or separation agreement). Cf. *Farid-Es-Sultaneh, supra.* There are, however, two answers to the seeming anomaly. The first is that it is not necessarily incongruous that both taxes should be applicable, for the one is but a postponed tax on the economic gain accruing to the husband over the period during which the property appreciated in value, while the other is a tax on the transfer of the property. There is no more of a double tax than, say, when a gift is made of wages on which the income tax has been paid. The second answer is that a rule that transfers in exchange for a release of marital rights is not an income-taxable event would produce an equal anomaly—namely, that such transfers incident to a divorce would not be

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rights not adequate consideration. The holding that, if no such provision is applicable, such a transfer is not a gift is of much broader import and would apply to any transfer in exchange for a release of marital rights. See 340 U.S. at 112.

subject either to the income tax or to gift tax (*i.e.*, if the agreement is within two years of the divorce decree). Thus, even if a correlation of the income and gift tax consequences of such transfers be thought desirable or necessary—itself a debatable question—it can, under the present state of the law, be achieved only by Congress.

### D. IF AN EXCHANGE OF PROPERTY FOR A RELEASE OF MARITAL RIGHTS IS OTHERWISE A TAXABLE EVENT, THE AMOUNT OF THE GAIN REALIZED CAN PROPERLY BE MEASURED BY THE VALUE OF THE PROPERTY TRANSFERRED

We have considered above what we conceive to be the dispositive issue in this case—namely, whether a property settlement incident to a divorce should be treated as a taxable "exchange" of property for a release of a legal obligation or as a nontaxable "division" of property. Assuming that the transaction is in kind a taxable "exchange", however, there remains the question of measurement of the gain upon which the Court of Claims based its decision. The court assumed that the release of the wife's marital rights was a "receipt" by the husband in exchange for the property and that there was a gain, of the kind intended to be taxed, to the extent that the value of the wife's released rights exceeded the husband's basis for the property transferred. The obstacle, in its view, was that the value of the wife's rights could not properly be measured by the value of the property accepted by her in exchange for them; that there was no other way to measure that value and hence to compute the gain;

and, accordingly, that the gain could not be taxed because it could not be computed.

We propose to show in this point that the stated ground of the Court of Claims' opinion is unsupportable and that, if the transaction is otherwise to be treated as a taxable exchange, the only feasible solution is to accept the value of the property transferred as the measure of the value of the wife's marital rights released in exchange.

1. In part, the opinion of the Court of Claims, and that of the Sixth Circuit in *Marshman* on which it relied, seems to imply that the value of what is received in an exchange can never be measured by the value of what is given—for example, even in the case of a transfer of property in settlement of a tort claim. To that extent, the court seems plainly wrong, for the valuation of property having no readily ascertainable market value in terms of the value of property exhanged for it is not uncommon. Thus, where there is no independent evidence of its value, the value of stock issued by a corporation in exchange for property is frequently determined by the value of the property. *E.g., Maine Steel, Inc.* v. *United States,* 174 F. Supp. 702, 714 (S.D. Me.); *Avco Mfg. Corp.* v. *Commissioner,* 27 T.C. 547, 556; *Livingston* v. *Commissioner,* 18 B.T.A. 1184, 1191. That method of valuation involves no more than the assumption that the parties judged the value of the property exchanged, in the arm's-length transaction, to be the equal of the property acquired, combined with the principle that their valuation should control in the absence of other evidence. *Kitrell* v.

*United States,* 79 F. 2d 259, 261 (C.A. 10). As explained by the Court of Claims itself in a prior case involving the issuance of stock in exchange for property (*Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189):

> The determination of whether the cost basis of the property received is its fair market value or the fair market value of the property given in exchange therefor * * * is generally not of great practical significance because the value of the two properties exchanged in an arms-length transaction are either equal in fact, or are presumed to be equal. * * *

Similarly, in a decision subsequent to its decision in *Marshman,* the Sixth Circuit, having held that an employers' transfer of appreciated property to its employees as additional compensation constituted a taxable event on which the gain should be recognized, had no difficulty in concluding that, lacking any better measure, the gain could properly be measured by reference to the value of the property transferred. *United States* v. *General Shoe Corp.,* 282 F. 2d 9, certiorari denied, 365 U.S. 843. The Second Circuit had reached the same conclusion, on substantially similar facts, in *International Freighting Corp.* v. *Commissioner,* 135 F. 2d 310 (C.A. 2).[19]

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[19] We do not cite the *General Shoe* and *International Freighting* cases for their holdings that the transactions there involved were taxable events. Since we here rely on the release of a legal obligation, not present in those cases, as the receipt, the question whether there was a taxable event in this case is significantly different from that presented in those cases. We cite them only for the subordinate holding that, a taxable event once being found, the gain can properly be measured by the value of the property transferred.

2. Since both the Court of Claims and the Sixth Circuit have found no difficulty in other contexts with the use, if necessary, of a presumption that the values of exchanged properties are equal, it seems evident that the real holding, both here and in *Marshman,* was limited to the peculiar circumstances of marital property settlements. The basis for the decisions is thus to be found in the courts' common references to the "emotion, tension and practical necessities" involved in divorce negotiations, under which, in the Sixth Circuit's words (279 F. 2d at 32):

> * * * values are lost sight of, concessions are made, one does not expect or insist upon getting his money's worth for what he gives up. [Often what the husband gives] * * * is not given merely in exchange for a release of alimony and dower rights, but also includes, without being so labelled, such additional amount as the husband may be willing to pay in order to have the marriage terminated. A property settlement in a divorce proceeding is usually influenced and often dictated by numerous intangible, personal considerations * * *. The value of what is given up is no criterion of the fair market value of the "property" received.

There is, of course, much truth in those observations. To a degree probably uncommon in other kinds of negotiations, there may be many non-legal factors influencing the husband's willingness to agree to the wife's demands—not limited to what he may be prepared to pay to "buy" his wife's acquiescence in the divorce, but including such intangibles as feelings of guilt and societal or family pressures. And

to that extent, it is of course not mathematically precise to say that the final settlement reached necessarily reflects simply the parties' valuation of the legal rights of the wife. We also agree that it would be quite unworkable to make the result turn upon an analysis of the negotiations in each particular case to guess at what "factors" were in fact considered.

One may, however, recognize the infirmities in the premise without concluding it must be abandoned. However rough and ready the measure may be, it is the best available, and having concluded that the transaction produces the kind of gain that Congress wanted to be taxed, it is surely not an adequate effectuation of that purpose to balk at the imperfections in the tools available to measure it. Nor is this an area in which precise measurement of the values affects vital interests. Whatever the value is at which the husband is taxed will become the wife's basis in the property, and an error in that valuation will wash out—but for a shift in the incidence of the tax that can be taken into account in the negotiations—upon the wife's later sale of the property with a correspondingly reduced gain.

More basically, once it is determined that the transaction should be treated as taxable, there is simply no escaping the duty of making a valuation of some kind, if only by the use of a burden-of-proof rule, in order to determine the tax consequences to the taxpayers. Thus, while not styled as such, the net effect of the Court of Claims' holding that the taxpayer realized no taxable gain—and presumably is not to be allowed a deductible loss—is to treat the

"value" of what was received as precisely equal to the taxpayer's *basis* for the property transferred, a measure which most assuredly has nothing to commend it. It is surely preferable to utilize the best measure available than to resort to rules producing results having no justification at all. The one may be wrong, but the other is certain to be. Cf. *Helvering* v. *Safe Deposit Co.,* 316 U.S. 56, 66–67.

Additionally, once the question is seen solely as one of valuing the wife's marital rights, the court's decision cannot be squared with the burden-of-proof rules, for the burden was on the taxpayer to prove the assessment wrong, not upon the government to prove it right. *E.g., Commissioner* v. *Hansen,* 360 U.S. 446, 468. The result of the absence of any acceptable evidence of the value of what was received should, therefore, have been a judgment, not for the respondent, but for the government.

3. Finally, in terms of the consistency of the basis consequences to the wife, the ground adopted by the Court of Claims is the least justifiable of all the alternative grounds of decision available. Since the court views the settlement as a taxable exchange—*i.e.,* a "sale" of the property by the husband and a "purchase" of it by the wife, the "price" of which is the release of her marital rights—there seems no ground on which the husband's basis for the property would carry over to the wife, and she would acquire a new "cost" basis. But the court's holding that the "price" received by the husband (the release of the wife's marital rights) cannot be measured equally means that the "price" paid by the wife—*i.e.,* her

"cost" basis—cannot be measured. The only consequence that seems possible is that the wife would have to take a zero basis for the property. The result is that the wife, upon a subsequent sale of the property, would be taxable on the entire proceeds even if they were in fact less than the amount the husband originally paid for the property.

Here again it may be noted that the Court of Claims' reluctance to indulge the assumption that the wife's rights were worth what the husband agreed to pay, and she to accept, for them does not mean that the necessity for attaching some measure to them, at least in legal effect, disappears. It only operates to resolve the problem in the worst possible way, imposing upon the wife the same legal consequences that would follow from a determination that her rights were worth nothing.

In summary, while the ambiguity inherent in divorce negotiations and the possibility that the final settlement may reflect elements other than the parties' appraisal of the value of the wife's legal rights may be a relevant consideration in determining whether property settlements should be treated as taxable events at all, we do not believe it is a defensible solution to the problem to say that the transaction is in nature a taxable "exchange" but that the value of the receipts cannot be measured. Such an approach first makes the tax consequences dependent upon ascertaining that value and then, by refusing to make such a valuation, leaves them to be determined by a burden-of-proof rule that operates without regard to consistency of treatment between the two parties. If the

transaction is to be treated as a taxable event, there is, we submit, no choice but to adopt a workable rule for measuring the value of the wife's rights—and, thereby, the husband's gain and the wife's basis—and for that purpose no other solution is available but to accept the value of the property transferred as the measure.

To conclude this Point of the brief, we submit that property settlements incident to a divorce, while admittedly *sui generis* and not readily fitting into any established category, are most closely akin to, and ought to be treated as, taxable dispositions in satisfaction of independent liabilities, in which event the amount realized can properly be measured, in the absence of direct evidence of value, by the value of the property transferred. We acknowledge, however, that such transfers can tenably be assimilated to, though again they do not have all the characteristics of, "divisions" of property among those having rights to "shares" of it. Should the Court decide the case in favor of the respondent, we urge it to do so upon that ground rather than upon the stated ground of the Court of Claims' decision.

## II

### THE ATTORNEYS' FEES WHICH TAXPAYER'S WIFE INCURRED AND TAXPAYER PAID FOR TAX ADVICE IN CONNECTION WITH THE SEPARATION AND PROPERTY SETTLEMENT AGREEMENT INCIDENT TO THEIR DIVORCE ARE NOT DEDUCTIBLE BY TAXPAYER AS ORDINARY AND NECESSARY EXPENSES PAID "IN CONNECTION WITH THE DETERMINATION, COLLECTION, OR REFUND OF ANY TAX"

In accordance with the customary practice under Delaware law, taxpayer paid the attorneys' fees which both he and his wife incurred in connection with the separation and property settlement agreement they executed as an incident to their divorce. The fees paid included $5,000, paid in 1955, for advice as to the tax consequences of the proposed separation and property settlement agreement. Half of that amount was paid to the taxpayer-husband's attorney for advice given to him and the other half was paid to the wife's attorney for advice given to her. The taxpayer claimed a deduction for the entire $5,000 under § 212 (3) of the 1954 Code, which allows a deduction for the "ordinary and necessary expenses paid * * * in connection with the determination, collection, or refund of any tax." The Court of Claims allowed the deduction, under that section, of the $2,500 paid to the taxpayer's own attorney but denied the deduction for the $2,500 paid to the wife's attorney (R. 103-104).[20]

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[20] In addition to the $5,000 paid for tax advice and claimed to be deductible under § 212(3), the taxpayer had also paid fees for services rendered in the negotiation of the settlement agreement. For the latter he claimed a deduction under § 212(2), allowing a deduction for expenses incurred for the "manage-

Since the government, in its petition (No. 190), presented only the question dealt with in Point I of this brief (realization of gain), and did not seek review of the allowance of the deduction for the fees paid taxpayer's own attorney, the only issue of deductibility directly before the Court is the denial of the deduction claimed for the $2,500 paid to the wife's attorney for tax advice given to her (*i.e.*, the question presented by the taxpayer's cross-petition in No. 268). On that question, the decision below is, we believe, plainly correct. Fees incurred for advice as to the tax consequences of a proposed separation and property settlement agreement do not fall within the statutory allowance of expenses incurred in connection with the "determination, collection, or refund of any tax." Thus no deduction should have been allowed even for the tax-advice fees paid to the taxpayer's own attorney. In no event, moreover, can the taxpayer be entitled to a deduction for his wife's fees, for regardless of their nature as to the wife they were not "his" expenses.

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ment, conservation, or maintenance of property held for the production of income." That deduction was disallowed by the Court of Claims, however, and the taxpayer's petition did not seek review of that part of the decision. Thus the question in this case, though broadly related to the question in *United States* v. *Gilmore*, No. 255, and *United States* v. *Patrick*, No. 256, turns upon a different subsection (§ 212(3)) than the question in those cases (§ 212(2)) and presents a quite different issue of statutory interpretation.

A. ATTORNEYS' FEES FOR ADVICE AS TO THE TAX CONSEQUENCES OF PROPOSED TRANSACTIONS ARE NOT EXPENSES PAID IN CONNECTION WITH THE "DETERMINATION, COLLECTION, OR REFUND OF ANY TAX"

Both the wording of the statute and its legislative history make clear that the provisions of § 212(3) go no further than to allow the deduction of expenses incurred for the purpose of computing and contesting tax liability. Congress did not intend to allow a deduction for expenses incurred, as here, simply for advice as to the tax consequences of proposed future transactions.

The statute provides a deduction for ordinary and necessary expenses paid "in connection with the determination, collection, or refund of any tax." It cannot be contended that fees paid for advice as to the tax aspects of the various proposals under consideration in connection with the settlement agreement were paid in connection with either the "collection" or "refund" of any tax. It is equally clear that these fees were not paid for the "determination" of any tax. Determination of tax liability, no less than collection or suit for a refund, is something which can be done only *after* taxable or deductible transactions have occurred.

Doubtless in the present case each attorney advised his client how to shape his or her demands so as to minimize the resulting tax liability. But this was not a "determination * * * of any tax." Not only was there was no tax yet owing from the proposed transaction which could be determined, but the attorneys were not retained to determine the amount of any tax but only to plan a transaction so as to minimize the annual tax, whatever it might later turn out to be. Indeed, even if the attorneys had been retained to determine the effect

on each party's annual tax of the settlement transaction, they could not have done so, for such a determination is impossible without knowledge of the other transactions and events which would take place during the year and would affect the computation of tax liability.

Moreover, the Treasury Regulations on Income Tax (1954 Code), § 1.212–1(l), *infra*, p. 54, provide explicitly that the expense which is made deductible by § 212(3) is only for assistance in the computation or contesting of an accrued tax liability:

> Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining *the extent of* his tax liability or in contesting his tax liability are deductible. [Italics supplied.]

The only activities which are recognized as being "in connection with the determination, collection, or refund of any tax" are those involved in the preparation of tax returns and in the determination and contesting of the extent of the taxpayer's liability. It is hardly necessary to repeat that the attorneys' functions in the present case were not and could not be a determination of *the extent of* the tax liability of either the taxpayer or his wife.

This reading of § 212(3) as applicable only to the cost of computation or contesting of an accrued tax lia-

bility is substantiated by the legislative history of the provision. In fact, the sole doubt as to the meaning of § 212(3) which survives a reading of the committee reports is as to whether only the expenses of contesting tax liability were to be deductible or whether, as the Treasury has construed the statute, expenses of computation were also deductible.

The Ways and Means Committee report (H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 29, A59) stated that—

> Existing law allows an individual to deduct expenses connected with earning income or managing and maintaining income-producing property. Under regulations costs incurred in connection with *contests* over certain tax liabilities, such as income and estate taxes, have been allowed, but these costs have been disallowed where the *contest* involved gift-tax liability. A new provision added by your committee allows a deduction for expenses connected with determination, collection, or refund of any tax liability. [Italics supplied.]
>
> * * * * *
>
> Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a *contested* tax liability, whether the *contest* be Federal, State, or municipal taxes, or whether the tax be income estate, gift, property, and so forth. Any expenses incurred in *contesting* any liability collected as a tax or as a part of the tax will be deductible. [Italics supplied.]

The House report's emphatic repetition of the term "contest" was noted by the American Bar Association Section of Taxation, which pointed out at the Senate hearings on the new provision (1 Hearings before the Committee on Finance on the Internal Revenue Code of 1954, p. 487):

> While the language of section 212 by itself would appear not to present any particular problems, the language of the committee report on page A59 does raise a new problem with respect to the language of the bill. The language of the committee report appears to confine expenses in connection with tax matters to contested tax liabilities under paragraph (3) of section 212. Since a specific provision ordinarily controls a general provision, this might have the effect of limiting deductions with respect to all taxes, including even income taxes, to contested matters. It is believed that this result was not intended.
>
> This problem might be eliminated by adding the word "computation" before "determination" in section 212(3). In any event, the Senate Finance Committee report should clarify the point that deductions with respect to taxes are not hereafter to be confined to contested taxes.

Although the proposed clarification of the legislative history would have gone no further than the Treasury has now gone in recognizing the deductibility of services connected with the filing of a return, no action was taken on the suggestion of the American Bar Association. The language of the Senate Finance Committee report is substantially identical to that of the Ways

and Means Committee (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 218):

> Paragraph (3) is new and is designed to permit the deduction by an individual of legal and other expenses paid or incurred in connection with a *contested* tax liability, whether the *contest* be Federal, State, or municipal taxes, or whether the tax be income, estate, gift, property, and so forth. Any expenses incurred in *contesting* any liability collected as a tax or as a part of the tax will be deductible. [Italics supplied.]

In sum, the plain meaning of § 212(3) and of the Treasury Regulation interpreting the section is more than confirmed by the legislative history of the provision. One could argue, as the American Bar Association did, that the committee reports suggest that even the expense of computation of an accrued tax liability does not fall within the words "determination * * * of any tax". But there is little room for doubt that at the very most § 212(3) was intended to include only the expenses of preparation of returns and of contesting tax liability.

### B. TAXPAYER IS NOT IN ANY EVENT ENTITLED TO DEDUCT THE LEGAL FEES FOR TAX ADVICE WHICH HIS WIFE INCURRED

The attorneys' fees incurred by taxpayer's wife for tax advice and paid by him would not be deductible by taxpayer under § 212(3) even if it were less clear that Congress did not intend to allow a deduction under that section for fees for tax advice in relation to prospective transactions. True, taxpayer became obligated, by his own agreement, to pay the

wife's fees. But "[t]he mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction * * *"; "[t]he origin and nature, and not the legal form, of the expense sought to be deducted determines" deductibility. *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 594. The fees paid to his wife's attorney were not for services rendered to the taxpayer, or even for services inuring indirectly to his benefit. As the court below stated (R. 104) in denying him a deduction for the wife's fees:

> In spite of the facts that Mr. Davis was legally liable for his wife's attorney's fees, the evidence conclusively shows that Mr. Morford worked exclusively for his client, Mrs. Davis, and considered the problems from the standpoint of his client alone. Certainly then it cannot be said that Mr. Morford's advice was directed to plaintiff's tax problems, and in order to qualify for a deduction, we think the attorney's fees must be directly and only connected with the taxpayer's estate. * * *

Thus, while tax advice was the subject matter of the wife's attorneys' fees, taxpayer's payment of these fees was not, as to him, an expense paid for tax advice. It was, instead, simply a part of his settlement with his wife—a liability which he assumed because he was advised that under Delaware practice it was customary for the husband to pay the wife's legal fees in connection with negotiations for a separation and property settlement agreement (R. 120). Cf. *Baer* v. *Commissioner,* 196 F. 2d 646,

649 (C.A. 8th); *Lewis* v. *Commissioner,* 253 F. 2d 821, 828 (C.A. 2d); *Richardson* v. *Commissioner,* 234 F. 2d 248, 250–252 (C.A. 4th). Section 212(3) does not allow husbands a deduction for payments made in discharging separation and property settlement obligations to a divorced wife.

## CONCLUSION

The decision below should be reversed on the first issue (No. 190) and affirmed on the second issue (No. 268).

Respectfully submitted.

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# APPENDIX

Internal Revenue Code of 1954:

SEC. 61. GROSS INCOME DEFINED.

(a) *General definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

* * * * *

(3) Gains derived from dealings in property;

* * * * *

(26 U.S.C. 1958 ed., Sec. 61.)

SEC. 63. TAXABLE INCOME DEFINED.

(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term "taxable income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

* * * * *

(26 U.S.C. 1958 ed., Sec. 63.)

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

* * * * *

(3) in connection with the determination, collection, or refund of any tax.

(26 U.S.C. 1958 ed., Sec. 212.)

SEC. 1001. DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. In determining the acount realized—

(1) there shall not be taken into account any amount received as reimbursement for real property taxes which are treated under Section 164(d) as imposed on the purchaser, and

(2) there shall be taken into account amounts representing real property taxes which are treated under section 164(d) as imposed on the taxpayer if such taxes are to be paid by the purchaser.

(c) *Recognition of gain or loss.*—In the case of a sale or exchange of property, the extent to which the gain or loss determined under this section shall be recognized for purposes of this subtitle shall be determined under section 1002.

* * * * *

(26 U.S.C. 1958 ed., Sec. 1001.)

SEC. 1002. RECOGNITION OF GAIN OR LOSS.

Except as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined under section 1001, shall be recognized.

(26 U.S.C. 1958 ed., Sec. 1002.)

8 Delaware Code Annotated, Title 12:

§ 901. *Widow's dower right*

The widow of any man, dying since February 16, 1816, who during their marriage was seized of an estate of inheritance in any lands or tenements within this State, shall have the third part of all the lands and tenements whereof her husband was seised at any time during the marriage, to hold to her as tenant in dower for and during the term of her natural life, free and discharged from all and every alienations, covenants, debts, liens and incumbrances, made, entered into, contracted, or created by the husband after the intermarriage, unless she shall have relinquished her right of dower therein by her own voluntary act, according to the existing laws of the State.

Title 13:

§ 1531. *Allowance or division of property upon divorce granted for aggression*

(a) When a divorce shall be decreed for the aggression of the husband, the complainant shall be restored to all her real estate, and allowed, out of her husband's real and personal estate, such share as the court thinks reasonable; but if the divorce be for the wife's aggression, the court may restore the whole or a part of her real estate, and also such share of her husband's personal property as seems reasonable.

(b) Any allowance or division of property under subsection (a) of this section, may be by a gross sum, or an annual allowance, or an assignment by metes and bounds. The court may appoint commissioners to execute any order in the premises, and may issue writs of possession, as in case of land sold on execution process.

1 Nevada Revised Statutes:

§ 125.150. *Alimony and adjudication of property rights; subsequent modification by court on stipulation of parties*

1. In granting a divorce, the court may award such alimony to the wife and shall make such disposition of the community property of the parties as shall appear just and equitable, having regard to the respective merits of the parties and to the condition in which they will be left by such divorce, and to the party through whom the property was acquired, and to the burdens, if any, imposed upon it, for the benefit of the children.

2. The court may also set apart such portion of the husband's property for the wife's support and the support of their children as shall be deemed just and equitable.

* * * * *

Treasury Regulation on Income Tax (1954 Code):

§ 1.212-1. *Nontrade or nonbusiness expenses.*—

* * * * *

(l) Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of the tax liability or in contesting his tax liability are deductible.

* * * * *

§ 1.1001-1. *Computation of gain or loss*—(a) *General rule.* Except as otherwise provided in subtitle A of the Code, the gain or loss realized from the conversion of property into cash, or

from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained. The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value. The general method of computing such gain or loss is prescribed by section 1001, which contemplates that from the amount realized upon the sale or exchange there shall be withdrawn a sum sufficient to restore the adjusted basis prescribed by section 1011 and regulations thereunder (i.e., the cost or other basis adjusted for receipts, expenditures, losses, allowances, and other items chargeable against and applicable to such cost or other basis). The amount which remains after the adjusted basis has been restored to the taxpayer constitutes the realized gain. If the amount realized upon the sale or exchange is insufficient to restore to the taxpayer the adjusted basis of the property, a loss is sustained to the extent of the difference between such adjusted basis and the amount realized. The basis may be different depending upon whether gain or loss is being computed. For example, see section 1015(a) and the regulations thereunder.

* * * * *

§ 1.1002–1. *Sales or exchanges*—(a) *General rule*. The general rule with respect to gain or loss realized upon the sale or exchange of property as determined under section 1001 is that the entire amount of such gain or loss is recognized except in cases where specific provisions of subtitle A of the Internal Revenue Code of 1954 provide otherwise.

(b) *Strict construction of exceptions from general rule*. The exceptions from the general rule

requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule. The exchange must be germane to, and a necessary incident of, the investment or enterprise in hand. The relationship of the exchange to the venture or enterprise is always material, and the surrounding facts and circumstances must be shown. As elsewhere, the taxpayer claiming the benefit of the exception must show himself within the exception.

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Nos. 190 and 268

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1961

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UNITED STATES, *Petitioner*

v.

THOMAS CRAWLEY DAVIS *and* GRACE ETHEL DAVIS

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THOMAS CRAWLEY DAVIS *and* GRACE ETHEL DAVIS
*Petitioners*

v.

UNITED STATES

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**ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS**

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**BRIEF FOR THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS**

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STATUTES AND REGULATIONS:

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## ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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## BRIEF FOR THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS

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### Questions Presented

1. Whether Thomas Crawley Davis realized a gain subject to federal income tax when he transferred stock to his former wife as part of a division of their property pursuant to an agreement between them executed during their marriage. (No. 190).

2. Whether Thomas Crawley Davis is entitled to deduct tax counsel fees paid to his wife's attorney. (No. 268).

## STATEMENT

The government brief contains a fair statement of the material facts bearing on both issues in this case except that it fails to point up the fact that the transfer of du Pont stock to the taxpayer's wife was a part of a "division in settlement of their property" and the parties made entirely separate provisions for the discharge of the taxpayer's obligation to support his wife and minor child. (R. 93-96).

## SUMMARY OF ARGUMENT

### I

### HUSBAND'S REALIZATION OF GAIN ON TRANSFER OF PROPERTY AS PART OF A DIVISION OF PROPERTY (190)

The government concedes that the only support for a decision in its favor on the first question is the "force of precedent".

There are two decisions by Courts of Appeal which are precedents for a rule that, where a husband tranfers appreciated property to his wife in discharge of his obligation to support his wife and children, he thereby realizes a gain subject to income tax. *Commissioner* v. *Mesta,* 123 F. 2d 986 (3d Circ., 1941) cert. den. 316 U.S. 695 and *Commissioner* v. *Halliwell,* 131 F. 2d 642 (2d Circ., 1942) cert. den. 319 U.S. 741.

There are no precedents for a rule which would treat as a taxable event for the husband his transfer of appreciated property as part of a division of property incident to a marital separation.

A. For a transfer to be a taxable event it must be a part of a "sale or other disposition" in which the transferor receives money or property with a fair market value.

The transfer in this case was obviously not a part of a "sale". Neither was it a part of a "disposition" comparable to a sale.

B. The transfer is most nearly analogous to a transfer of community property on dissolution of a marriage of couples residing in a community property law jurisdiction, which the government agrees is not a taxable event.

C. The transfer in this case is also closely analogous to a transfer of property to a partner or stockholder on dissolution of a partnership or corporation. The government agrees that such transfers are not taxable events.

D. The government suggests not applying in this situation the rules applicable in situations which are closely analogous. The sole basis for that suggestion is what the government perceives to be the "force of precedent" of lower court decisions. Taxpayers deny the existence of a "force of precedent" pushing in the government's direction.

However, even if such "force of precedent" existed, it would not outweigh the more important and far reaching adverse consequences of a decision for the government on this issue. A decision against this taxpayer on this issue would create the following seriously adverse consequences for the government, taxpayers and the courts:

1. There would be a difference of income tax treatment as between spouses residing in community property jurisdictions and those residing in common law property jurisdiction. This difference would be based on no practical differences, but solely on "elusive and subtle casuistries".

2. A tax will be imposed when the taxpayer is depleting, rather than adding to, his estate. The imposition of the tax may in itself force sales of other property with a consequent "snowballing" effect.

3. To measure the husband's gain will require the courts to engage in the practically foredoomed pursuit of a fair market valuation of the consideration moving to the husband. Alternatively, the courts will have to accept the unrealistic assumption that in all cases the value of the consideration received by the husband is exactly equal to the value of the property he gives up.

4. A decision for the government on the basic issue

in this case would require a further and consistent holding that the taxpayer either had a deductible loss or that the gain if any occurred in a year other than that before the Court.

No precedents require a decision for the government on this issue. No good policy will be served by a decision in favor of the government. A decision for the taxpayer would be consonant with a fair and workable rule of taxation and a uniform tax system.

## II

## THE TAXPAYER IS ENTITLED TO DEDUCT TAX COUNSEL FEES PAID TO THE ATTORNEY REPRESENTING HIS WIFE (268)

The Court of Claims decided that legal fees for advice regarding the tax consequences of various proposals made in connection with the separation and property settlement agreement qualify as expenses "in connection with the determination, collection, or refund of any tax". Section 212(3) of the Internal Revenue Code of 1954. Accordingly, the Court of Claims held that Mr. Davis was entitled to deduct such legal fees paid to the attorney representing him. The government did not file a petition for review of that decisio

However, the Court of Claims held that Mr. Davis was not entitled to deduct legal fees of an identical type paid to the attorney representing the taxpayer's wife. The sole basis for that decision was that the fees were paid for tax counseling as to the problems of the taxpayer's wife, rather than those of the taxpayer. The taxpayer petitioned for review of that decision.

A. The fees for tax counsel are within the ambit of the plain words of Code § 212(3). The Treasury Regulations under that section of the Code so state. The fees in question were, as decided by the Court of Claims, within the statutory rule.

The arguments advanced by the government are based upon: (1) a misconception of the significance of language appearing in reports of Congressional committees, and; (2) a use of a minuscule part of a voluminous written statement submitted after a Senate Finance Committee hearing, which use is both misdirected and banned by case authority.

B. Mr. Davis paid his wife's counsel fees because they were a direct obligation of his under the basic rule of law which requires a husband to pay for "necessaries" furnished to his wife. Mr. Davis's payment of such fees was not "merely a part of his settlement with his wife". The payment was made in recognition of his direct liability for the payment of such fees.

There is no authority to support the conclusion that § 212(3) of the 1954 Code is limited to expenses for tax counselling with respect to the payor-taxpayer's own tax problems. On the contrary, the authorities point towards the opposite conclusion.

## ARGUMENT

## I

### A. TAXPAYER'S TRANSFER OF PROPERTY TO HIS WIFE AS PART OF A MARITAL PROPERTY SETTLEMENT WAS NOT A DISPOSITION RESULTING IN TAXABLE GAIN TO HIM

The government's arguments on the issue of whether the taxpayer realized a taxable gain by virtue of his transfer of property to his wife are based on the assumption that all marital property settlements are of a kind and that Mr. Davis's case is similar to every other case in this area of the law. It may be that there should be one uniform and all-encompassing rule with respect to the income tax effects of transfers of property between spouses on separation or divorce. It may be that the Court will see fit to decide

this case on a basis which establishes such a single, uniform and all-encompassing rule. It may be that the Congress some day will enact legislation which will establish such a single, uniform and all-encompassing rule. However, in considering the first question presented by this case, the applicable authorities should be applied in terms of the particular facts in this case and not in terms of marital property settlements of all types.

The government's basic approach to this issue is (1) to concede that marital property settlements are *sui-generis* (Govt. Br. 20), (2) to set forth the income tax rules in situations which are analogous in varying degrees (Govt. Br. 20-22), (3) to suggest various factors which should be considered in deciding which of varying rules from analogous areas should be applied in this area (Govt. Br. 25-29) and (4) to conclude that the rule it urges should be accepted solely on the basis of "the force of precedent". (Govt. Br. 27-28).

The taxpayers propose to follow much the same basic approach to this issue and to demonstrate that a decision in favor of the taxpayer is more consonant with existing authorities, and a fair and uniform rule of taxation. The taxpayers propose to lay greater stress on the facts in this case.

The statutory provision governing the first issue in this case is § 1001 of the Internal Revenue Code of 1954 [1] which in pertinent parts provides:

> "(a) Computation of Gain or Loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

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[1] Throughout this brief references to the "Code" are to the Internal Revenue Code of 1954, 68A Stat. unless otherwise indicated.

"(b) Amount Realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. * * *".

To bring Mr. Davis's transaction within the quoted provisions of Code § 1001, the government must demonstrate the presence of two essential factors, i.e., (1) a "sale or other disposition" and (2) a realization through receipt of "property" which has a "fair market value".

In *First Saving Bank of Ogden* v. *Burnet*, 53 F. 2d, 919 (1931), the Court of Appeals for the District of Columbia held that a corporation did not have a recognized loss for income tax purposes when it made an in kind dividend distribution of stock of another corporation. There, as in this case, the court was faced with the question whether the transaction could properly be described as a "sale or other disposition". The court there concluded that the term "other disposition" used in conjunction with the word "sale" was intended by Congress to connote transactions which were "like sales". It is submitted that the same rule of *ejusdem generis* should be applied in the present situation and Mr. Davis should be treated as having had a realization of gain or loss only if his transfer of stock to his wife was a transaction "like a sale".

Under the well-established income tax rules in analogous situations the transfer in this case is not "like a sale".

The government correctly states the rules in some analogous situations. (Govt. Br. 20-23). These include the rules that: (1) there is no taxable gain or loss realized by an estate or trust by virtue of an in kind distribution to satisfy a beneficiary's claim for a share of property or for a bequest of specific property; (2) there is no realization of taxable gain on the partition of jointly owned property; (3) a division of partnership property among partners on dissolution is not a transaction resulting in taxable gain; (4) a division of community property between the husband

and wife upon divorce is not a taxable event; and (5) a corporate distribution of a dividend payable in shares of stock of another corporation does not result in taxable gain for the distributing corporation.

An additional situation which is closely analogous to that present in this case is the one in which a corporation distributes appreciated property to its stockholders in liquidation. It has long been recognized that such a distribution does not give rise to taxable gain or deductible loss for the distributing corporation.[2]

Mr. Davis's transfer of stock to his wife was pursuant to the provisions of their property settlement and separation agreement which related to the division of their property. (R.93). The agreement is clear to the effect that other provisions were made for the discharge of Mr. Davis's obligation to support his wife and minor child. (R. 95, 96).

The transfers which are the subject of this litigation were in a real sense made as distributions in "liquidation" of the couple's marital partnership. A comparison of the situation in this case and the various analogous situations recited above and recited in the government's brief, make it clear that the business situations furnishing the closest analogies are those involving the dissolution of a corporation or partnership. The government recognizes the aptness of this analogy in fixing rules with respect to transfers on dissolution of marriages of couples owning community property. See page 22 of the government brief where it is recognized that on a division of community property there is no sale or exchange giving rise to taxable gain or loss.

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[2] This rule was embodied in §336 of the Internal Revenue Code of 1954. However, the statutory provision merely reflected then existing law which had been established independently of the special statutory provision. See Treasury Regulations 118, §29.22(a)-20; H. Rep. 1337, 83rd Cong., 2d Sess. A90 and *Merten's Law of Federal Income Taxation*, Code Commentary, §336.

## B. THE RULE WITH RESPECT TO DIVISION OF COMMUNITY PROPERTY SHOULD BE APPLIED IN THE INSTANT CASE

The government recognizes the close analogy between the division of property present in this case and a division of community property (as to which no gain is realized on division) (Govt. Br. 22). Nonetheless, the government argues that there is a sufficient difference between a community property division and a common law property division to justify exactly opposite income tax results. The government asks the Court to hold that, while neither a husband or wife realizes taxable gain when they divide their community property incident to a divorce, the equivalent transaction in a common law jurisdiction gives rise to taxable gain. Thus, the government is asking the Court to introduce into the tax laws a serious divergence of treatment as between common law and community property law jurisdictions. Such a divergence constitutes a result to be avoided if possible. See dissenting opinion of Justice Douglas in *Commissioner* v. *Harmon,* 323 US 44, 49, 52, 56 (1944).

For a long time there existed a serious lack of uniformity as between the income, estate and gift tax treatment of spouses residing in community property law states and those residing in common law property states. As a result of a series of decisions by this Court,[3] the graduated income tax system was considerably blunted as it applied to husbands and wives residing in community property states by virtue of holdings that the husband and wife could each report as separate income their respective shares of the earnings of each. At the same time, couples residing in common law property states were subjected to ever-increasing burdens of the highly graduated income tax sys-

[3] *Poe* v. *Seaborn* 282 US 101 (1930); *Goodell* v. *Koch,* 282 US 118 (1930); *Hopkins* v. *Bacon,* 282 US 122 (1930); *Bender* v. *Pfaff,* 282 US 127 (1930) and *U.S.* v. *Malcom,* 282 US 792 (1931).

tem by virtue of their inability to split their income between themselves. There was also a marked lack of uniformity in the estate and gift tax areas.

The situation prior to the enactment of the Revenue Act of 1948, 62 Stat. 110 is aptly described in *3 Mertens, Law of Federal Income Taxation*, §19.01:

> "* * * During the decade prior to 1949, the effect of these decisions [holding that a husband and wife in community property states could in effect split their income for federal income tax purposes] in conferring highly favorable treatment to community property taxpayers and in discriminating against spouses in states with a common law system of property, brought forth a vigorous stream of mounting protest and numerous proposals for rectifying the inequality. * * *"

Congress in 1942, recognizing the unfairness of the discrimination against common law property jurisdictions in the estate tax field, amended § 811 of the Internal Revenue Code of 1939 by § 402 of the Revenue Act of 1942, 56 Stat. 798. The background of that amendment is set forth in the opinion in ***Fernandez* v. *Wiener et al***, 326 US 340 (1945). The effect of the 1942 amendment was to impose in community property states an estate tax rule roughly comparable to that prevailing with respect to jointly held property in common law property jurisdictions, i.e., to include the entire value of community property owned by a husband and wife in the estate of the first to die except to the extent it could be shown that the survivor had acquired his or her interest by separate earnings.

The Court in ***Fernandez* v. *Wiener*** upheld the constitutionality of that provision. Justice Douglas, in a concurring opinion in the ***Fernandez*** case, in commenting on the taxpayer's argument with respect to the difference in spouse's property rights in community property and common law jurisdictions, said (326 US at 366):

> "* * * Congress, to be sure, has disregarded the manner in which Louisiana divided 'ownership' of property

between husband and wife. But as between husband and wife, notions of 'vested interest,' 'ownership,' and the like, established by local law, are no sure guide to what 'belongs' to one or the other in any practical sense. We would be blind to the usual implications of the intimate relationship of marriage if we forced Congress to treat such divisions of 'ownership' in the same way it does divisions of 'ownership' among strangers. I find no such compulsion in the Constitution.''

A statement of the lack of basic dissimilarity between the "property rights" of spouses residing in community and those residing in common law property jurisdictions is set forth in § 7.5 of *American Law of Property:*

> ''* * * Moreover, as a legal system it [the community property system] is, perhaps, more accurately reflective of actual marital customs and usages than its rival system. It has been asserted, with considerable justification, that the community idea exists extra-legally to a substantial degree in the common law states. Broadly speaking, the community system may be said to constitute a *de jure* recognition of a *de facto* marital partnership.''

To argue that for present purposes the division of property of spouses domiciled in Delaware is significantly different from the division of property of spouses domiciled in a community property state is to ignore not only the ''usual implications of the intimate relationship of marriage'' and the ''*de facto*'' situation in common law property jurisdictions, but to also ignore the significance of Delaware law with respect to a wife's interest in her husband's property. The government correctly describes the principal features of Delaware law with respect to a wife's interest in her husband's property, i.e., a wife has a dower interest in her husband's real estate, a statutory right to a minimum share of his estate, and a right to have awarded to her a part of the husband's property in case the marriage is dissolved by divorce. (Govt. Br. 22-23) While it can be argued that for certain purposes these interests of a wife in her husband's property in the common law jurisdiction of Dela-

ware are somehow different than the interests of a wife in community property in a jurisdiction operating under the community property law system, it is submitted that these differences are not significant for purposes of determining whether the husband realizes a taxable gain when on dissolution of their marital relationship the parties divide their property.

The practical similarity between the Delaware laws with respect to a wife's interest in her husband's property and the interest of a wife in community property jurisdictions is pointed up in §7.5 of the *American Law of Property* where it is observed:

> "* * * Against the community system it may be contended that due to the husband's extensive powers of management the protection given to the wife during marriage is largely theoretical and that in reality the protection begins when the community ends.* * *"

The similarities are also pointed up at § 7.35 of the *American Law of Property* where in commenting on the rules with respect to the respective spouses' interests in community property at the time of separation or divorce, it is stated:

> "In practice, the rights of the parties with respect to property interests are frequently established by the terms of a property settlement agreement entered into at the time of separation.* * *"

The government admits difficulties in differentiating between common law and community property law rules for present purposes. (Govt. Br. 22-23) After setting forth the rights of a Delaware wife in her husband's property, the government states:

> "With the possible exception of the dower rights in real estate, those inchoate rights plainly do not amount to a vested property interest in the property owned by the husband and, in traditional concepts, are quite

different from the 'property' interests of a * * * wife in a community property state.* * *"

In making such an argument, the government is turning its back on the teaching of *Helvering* v. *Hallock*, 309 US 106, 118 (1940), where it is stated:

> "* * * The importation of these distinctions and controversies from the law of property into the administration of the estate tax precludes a fair and workable tax system. Essentially the same interests, judged from the point of view of wealth, will be taxable or not, depending upon elusive and subtle casuistries which may have their historic justification but possess no relevance for tax purposes.* * * *"

In the absence of a statutory requirement or overwhelming precedent, the Court should not approve the introduction into the tax laws of an inequitable disparity of treatment as between various sections of the country merely on the basis of "elusive and subtle casuistries" embodied in such terms as "vested" and "inchoate".

Congress has recognized that disparities between common law and community property law jurisdictions are repugnant to a fair tax system and has attempted to eliminate these disparities for purposes of income, estate and gift taxes. The most sweeping elimination occurred in the Revenue Act of 1948[4], which introduced the split income provisions for income tax purposes, the split gift and marital deduction provisions for gift tax purposes and the marital deduction provision for estate tax purposes. These changes were introduced for the express purpose of achieving as nearly as possible equality between taxpayers in common law and community property law jurisdictions.[5]

To tax Mr. Davis on a transfer to his wife in division of property would therefore represent a regression which, if possible, should be avoided.

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[4] 62 Stat. 110.

[5] H. Rep. 1274, 80th Cong., 2d Sess., 1948-1 CB 241, 243 and 257-261; S. Rep. 1013, 80th Cong., 2d Sess., 1948-1 CB 285, 288 and 301-306.

## C. AUTHORITIES HOLDING THAT A HUSBAND REALIZES TAXABLE GAIN WHEN HE TRANSFERS APPRECIATED PROPERTY IN DISCHARGE OF AN ALIMONY OR SUPPORT OBLIGATION ARE NOT IN POINT

The government cites the decisions of the Third Circuit in *Commissioner* v. *Mesta*, 123 F. 2d 986 (3d Circ. 1941) cert. den. 316 US 695 and the Second Circuit in *Commissioner* v. *Halliwell,* 131 F. 2d 642 (2d Circ. 1942) cert. den. 319 US 741, as standing for the proposition that a husband realizes "taxable gain upon a transfer of appreciated property to his wife in discharge of marital obligations." Govt. Br. 16). That statement oversimplifies the law in this area. In the *Mesta* case, the property transfer which the Court of Appeals (in a 3 to 2 decision) held gave rise to a taxable gain was a transfer "* * * in full settlement * * * of all claims * * * for her maintenance and support * * *". In the *Halliwell* case, the transfer which the Court of Appeals held gave rise to a taxable gain was a transfer of securities intended by the parties as a payment for alimony and for the support of a child. In the *Halliwell* case, the parties had fixed a value for the various items of property transferred to the wife and had agreed that such values would be used in computing the discharge of the husbands' obligations under the agreement.

While the government speaks accurately when it refers to the *Mesta* and *Halliwell* cases as involving transfers in discharge of a husband's "marital obligations", it creates a misleading impression when it indicates that the marital obligations involved in the *Mesta* and *Halliwell* cases were of the same nature as those involved in the instant case.

In this case the marital property settlement and separation agreement are clear to the effect that the husband made specific provision for the discharge of his obligation to support his wife and minor child. (R. 95, 96). A completely separate provision in the agreement provided for the trans-

fer of securities which gave rise to this litigation. That transfer was not in discharge of any support or alimony obligation, but, rather, was a part of the division of the parties' property (R. 93, 94, 95).

The Internal Revenue Service has long recognized the distinction between transfers of property to satisfy a husband's obligation of support and alimony and transfers in division of property. In E. T. 19, 1946-2 CB 166, the Commissioner of Internal Revenue ruled that for gift tax purposes an inter-spouse transfer of property incident to a divorce did not constitute a taxable gift for gift tax purposes to the extent that the transfer was in discharge of the husband's obligation to support his wife, but that such a transfer was a taxable gift to the extent it was a transfer in consideration of the wife's release of her property or inheritance rights.

The taxpayers are aware of no existing authorities which support the proposition that a transfer of property by a husband to a wife *in connection with a division of their property* (as opposed to a transfer *in discharge of a support or alimony obligation*) gives rise to either a taxable gain or deductible loss by the husband. In the absence of compelling authorities, the Court should reject a rule requiring a husband to pay a tax at a time when he is depleting his estate by transferring property to his wife. The government suggests certain situations which have a certain surface similarity to a transfer in discharge of a support and alimony obligation. (Govt. Br. 20-21). However, the situations which the government suggests as supporting through analogy its side of this case are completely beside the point in a case in which the transfer is not in discharge of an alimony or support obligation, but rather is in division of the parties' property.

To say that a transfer of a parcel of property to a wife as a part of a property division is "a discharge of an obligation to the wife" merely because the wife has certain claims

against the property by virtue of her marital situation is to beg the question. The same could just as well be said in connection with a division of community property. In a community property situation, it could be said that a transfer of part of the community property to a wife is a transfer in discharge of the husband's obligation to transfer such property to the wife under certain circumstances. The same can be said in a partnership or corporation dissolution situation. In either of those situations a distribution of property by a corporation to a stockholder or by a partnership to a partner can be said to be a transfer in "discharge" of the corporation's or the partnership's obligation to divide the property among the stockholders or partners on dissolution. That argument does not advance the case.

## D. A CONSIDERATION OF THE PRACTICAL IMPLICATIONS OF THE DECISION IN THIS CASE MILITATES IN FAVOR OF AFFIRMING THE DECISION BELOW ON THE ISSUE OF REALIZATION OF TAXABLE GAIN

After analyzing what it perceives as the various "practical implications" of a decision either way in this case, the government concedes that all other considerations are "inconclusive" and that the only factor which is determinative in favor of treating the transfer in this case as a taxable exchange is the "force of precedent". (Govt. Br. 27-28).

The taxpayers submit that there is no "force of precedent" which requires the Court to decide that a husband has a taxable transaction when he transfers property to his wife in division of their property, as opposed to a transfer in satisfaction of a support and alimony obligation. Neither *Mesta, supra, Halliwell, supra, Farid-Es-Sultaneh* v. *Commissioner,* 160 F. 2d 812 (2d Circ. 1947) nor *Commissioner* v. *Patino,* 186 F. 2d 962 (4th Circ. 1950), stand for the proposition that the husband realizes taxable gain under the circumstances of this case. The last two cited cases were limited to the question of a transferee wife's (or bride's)

basis for property received from a husband or prospective husband. In the *Farid-Es-Sultaneh* case, the taxpayer acquired property in consideration of her promise to marry and in consideration of her ante-nuptial release of interests in her prospective husband's real property. The Court did not consider the question of whether the prospective husband realized gain on account of that transaction. In the *Patino* case, the taxpayer wife acquired corporate stock in exchange for her release of a fixed dollar alimony obligation and the agreement leading to the transfer specifically referred to the transfer as being in discharge of a fixed dollar obligation.

Regardless of the Court's conclusion as to the meaning of the *Mesta, Halliwell, Farid-Es-Sultaneh* and *Patino* decisions, there is no gainsaying the fact that there are no precedents in this Court for the conclusion for which the government contends.

Accepting for the moment, for the sake of argument, the government's proposition that the only "practical" implication which weighs in its favor in this case is the "force of precedent" (which the taxpayers deny), the case should be analyzed by putting over against that "practical" implication the "practical" implications of a pro-government decision.

The first practical implication of a pro-government decision in this area would be to create a diversity of rules as between common law and community property law jurisdictions. This problem is discussed in more detail above. This is a practical implication to be avoided if at all possible. The practical implication of the "force of precedent" pales into insignificance when set over against the practical implications of a rule which holds husbands in common law jurisdictions taxable while holding husbands in community property states are exempt from tax with respect to transactions which for all practical purposes of taxation are identical.

Another practical implication of a pro-government decision in this case would be to impose a tax on the transferor of property at the very moment when he is seriously depleting his estate. Such a rule will have serious "snowballing" effects in many cases. If under these circumstances it is determined that a husband has a taxable gain resulting in a liability for a cash payment to the government, the result may force the husband to sell property in order to raise cash to pay the tax. These further sales may, in turn, generate additional capital gains tax with a consequent need for further sales to pay such additional taxes.

A decision in favor of the taxpayer in this case will tend to place the tax burden on the wife, but at a time when she is in a position to pay the tax. By deferring the collection of the capital gains tax on the appreciation in value of property until such time as the wife sells the property, the tax will be imposed at a time when the wife has cash proceeds from the sale with which she can discharge the tax obligation.

A decision for the government in this case will also raise the very practical problem of how to compute and when to take into income the amount of gain realized by the husband.

This was a question posed in the *Mesta* and *Halliwell* cases where the husband transferred property in satisfaction of his support and alimony obligation. The Third Circuit solved this nettlesome problem of valuing the "consideration" moving to the husband by what amounts to a legal fiction, i.e.:

> "* * * We think that we may make the practical assumption that a man who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth." (123 F. 2d 988)

While such a pat statement may be appropriate in commenting on business transactions, the statement as applied to marital arrangements ignores the facts of life. This was recognized by the Court of Appeals for the Sixth Circuit in

*Commissioner* v. *Marshman*, 279 F. 2d 27, 32 (1961), cert. den. 364 US 918 where the Court in commenting on the quoted rule from the *Mesta* case said:

> "* * * A single transaction between a husband and wife under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule [that the fair market value of property is the value at which property would change hands between a willing buyer and a willing seller neither being under any compulsion to buy or sell.] * * *
>
> "* * * A property settlement in a divorce proceeding is usually influenced and often dictated by numerous intangible, personal and practical considerations which play no part in a transaction between a willing seller and a willing buyer in the open market. The value of what is given up is no criterion of the fair market value of the 'property' received."

The Sixth Circuit in the *Marshman* case and the Court of Claims in the instant case decided this issue against the government, principally on the ground that it was impossible to value the consideration moving to the husband in the transfers involved in that case and in this.

If this issue is decided against the taxpayer, the trial courts will be placed in the position of being required to make decisions as to the value of the consideration moving from the wife to the husband and this will have to be done on a case by case basis—absent a totally unacceptable conclusion such as that of the *Mesta* case that the husband will be presumed to have received his "money's worth".

The government cites scattered decisions by trial courts holding that where a corporation acquires property in exchange for its stock, the value of the stock is presumed equal to the value of the property received. (Govt. Br. 35-36). Such decisions make perfectly good sense in their own context. Where a corporation acquires property with a determinable value, its net worth is increased by exactly the value of the new property. It is a perfectly fair assumption that the new stock issued in the exchange can be equated

with the increase in corporate net worth. If a newly organized corporation issues all of its stock in exchange for a single asset worth $100, it is obvious that the value of the stock (representing the entire net worth of the corporation) is equal to the value of the only asset of the corporation. The transferor of the property there acquires a new interest in the same property by virtue of the transfer. None of this reasoning is applicable to the case of a husband's transfer of property to a wife incident to a dissolution of their marriage. Such a transfer may increase the wife's "net worth" by the value of the transferred property, but the husband receives no "property" even remotely comparable to a stock interest in the wife's increased net worth. The "net worth" of a person who exchanges property for stock ordinarily is not decreased by the exchange. In many instances the transferor's net worth is actually increased. However, a husband who transfers property to his wife thereby decreases his net worth. To argue to the contrary involves the unrealistic (and ungallant) assumption that a husband's personal balance sheet should show his wife and her interests in his property as "liabilities".

Cases holding that in situations where a taxpayer who claims an income tax deduction in the amount of the value of property transferred must measure his gain on the transaction by the same figure (Govt. Br. 36) also involve a consideration absent in this case. In the former situations there is a basic fairness in holding that a taxpayer who secures a tax benefit which he himself computes by use of value of transferred property must be bound by the same computation method in deterning his gain. However, that consideration is not relevant in Mr. Davis's situation—he has secured no tax benefit by virtue of his transfer.

The application of the *Mesta* rule of valuation (i.e., the husband receives his "money's worth") is practically impossible of application in the instant case and if applied literally raises the serious question as to whether the tax-

payer in this case had a loss rather than a gain and the further question as to the proper year of taxation.

Assume, for the sake of argument, that the transaction by which Mr. Davis transferred stock to his wife was a taxable exchange of stock for a consideration moving from his wife in the form of a release of her rights in his property. It follows that Mr. Davis, being on the cash basis of accounting, should report his gain from the transaction not in the year that the transfer occurs but in the year during which he receives the consideration for the transfer. The transfer which gave rise to this litigation occurred on March 21, 1955. In asserting deficiencies in tax, the Internal Revenue Service took the position that Mr. Davis had a taxable gain equal to the difference between his basis for the transferred stock and the fair market value of the stock on March 21, 1955—the date of the transfer. The fair market value was determined by computing the mean between the high and the low quotations for du Pont common stock on March 21, based upon stock quotations found in the March 22, 1955 edition of the Wall Street Journal. (R. 178). This mean was computed at $164.50 per share. It is submitted that that date is insignificant for purposes of determining either the value of the consideration moving to Mr. Davis or the time of its receipt.

The marital property and separation agreement was executed by the parties on November 4, 1954. It was on that date that Mr. Davis agreed to transfer to his wife 1,000 shares of du Pont common stock. On that date the mean between the high and the low of the quotations for du Pont common stock, as reported on page 14 of the November 5, 1954 edition of the Wall Street Journal, was $145.63 per share. If the conclusion of the Court of Appeals in the *Mesta* case is accepted and it is determined that there is a presumption that in negotiating a marital property settlement a husband receives his money's worth and that the so-called "money's worth" is the value of the property trans-

ferred, it would seem to follow that in valuing the consideration received by Mr. Davis it would be reasonable to use the value of du Pont stock as of the date he bound himself to deliver it, rather than as of the date he, in fact, delivered it. The government has never suggested, and it is obviously not a fact, that as of November 4, 1954, Mr. Davis had the divinatory power to know the March 21, 1955 value of du Pont stock over four months in advance of that date. If we assume that the consideration received by Mr. Davis was worth the value of the transferred property as of the date he executed the agreement, the transaction in 1955 resulted in a *loss* rather than a gain. This is so since Mr. Davis's basis for his du Pont stock transferred in 1955 was \$149.55 per share. Thus it exceeded the November 4, 1954 value of the stock by approximately \$4 per share.

If it is concluded that the transaction is a taxable event in which the consideration received by Mr. Davis was a release of his wife's interests in his property, there is an intriguing and serious question as to when this consideration was received. It might be contended that the consideration was received as of November 4, 1954, the date on which the settlement agreement was executed. However, it can also be argued that the agreement being executory as of November 4, 1954, the wife's release of her marital rights did not occur until 1956 when Mr. Davis made the second of two installment deliveries of stock as a part of a division of the parties' property. In either event, (i.e., in the event it is determined the consideration was received on execution of the agreement in 1954 or in the event it is determined that the consideration was received when the second of the two transfers of property occurred in 1956), it is obvious that the consideration was not received on March 21, 1955, the date the government has picked as the critical date.

Under the agreement between Mr. and Mrs. Davis, Mr. Davis was obligated to make periodic payments to his wife

for a period extending into 1964. It could well be argued that until Mr. Davis has fulfilled the last of his periodic payment obligations in 1964, the November 4, 1954 agreement does not serve to relieve him of his obligation to his former wife. This would mean that Mr. Davis has still not received the consideration which gives rise to a taxable gain under the government's theory of the case. Thus under any analysis, the government has picked the wrong year to tax the gain and the wrong figure for valuing the consideration received by Mr. Davis under the only rule ever suggested by it for fixing value, i.e., that set forth in the *Mesta* case.

The government concedes that all practical implications suggested by it are insignificant except the "practical implication" of the "force of precedent". There is no precedent for the conclusion for which the government contends in this case.

The taxpayers have demonstrated that there are serious adverse practical implications in a decision for the government in this case. Thus, an analysis of the case on the basis suggested by the government leads to the conclusion that the case should be decided in favor of the taxpayer.

## II

### A. MR. DAVIS IS ENTITLED TO DEDUCT TAX COUNSEL FEES PAID TO THE ATTORNEY REPRESENTING HIS WIFE

The Court of Claims considered the deductibility of two separate tax counsel fees. During the taxable year 1955, Mr. Davis paid tax counsel fees to an attorney who represented him and in addition paid tax counsel fees to an attorney who represented his wife in connection with the negotiation of their property division and separation agreement.

In the Court of Claims, the government contended that

neither tax counsel fee was deductible. In the case of the tax counsel fee paid to Mr. Davis's attorney, the government argued (as it is arguing here) that the counsel fee paid to Mr. Davis's own attorney was not deductible because it was not paid for services in connection with a "contested" tax matter. On this issue the Court of Claims held for the taxpayer and decided that the tax counsel fee paid by Mr. Davis to his own attorney was deductible under § 212(3) of the 1954 Code. The Court of Claims flatly rejected the government's arguments that § 212(3) was not intended to apply to fees for tax counselling. The government did not petition for *certiorari* with respect to that part of the decision of the Court of Claims.

The Court of Claims, after deciding that Mr. Davis was entitled to deduct tax counsel fees paid to his own attorney, decided that he was not entitled to deduct tax counsel fees paid to his wife's attorney for similar services. It based its decision on this point soley on the ground that the fees were paid to the attorney representing an adversary rather than to the taxpayer's own attorney. The taxpayer's petition for *certiorari* was limited to that point.

The government has now broadened the issue of deduction of the tax counsel fees paid to Mrs. Davis's attorney by introducing the argument rejected by the Court of Claims in connection with the deduction of the tax counsel fees paid to Mr. Davis's own attorney. The government, in effect, argues that § 212(3) of the Internal Revenue Code of 1954, which permits the deduction of "expenses paid * * * in connection with the determination, collection, or refund of any tax" is limited to "expenses incurred for the purpose of computing and contesting tax liability." (Govt. Br. 44). The government has widened its view of the meaning of § 212(3). It argued in the Court of Claims that only expenses for "contesting" tax matters are deductible. Now the government concedes that § 212(3) is broad enough to also include the expenses of "computing" tax liability.

If there was any doubt as to the fact that the statute is broad enough to encompass the type of legal services furnished Mrs. Davis by her attorney, that doubt is removed by the express provisions of the Treasury Regulations on Income Tax (1954 Code), § 1.212-1(1) where it is stated with respect to the meaning of § 212(3) in the 1954 Code:

> "Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be federal, state, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer *for tax counsel* or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of his tax liability or in contesting his tax liability are deductible." [Emphasis supplied]

The quoted Treasury Regulation flatly states that expenses for "tax counsel" are deductible. The quoted regulation makes it clear that tax counsel fees are deductible whether or not they are associated with the balance of the listed activities. In ordinary lawyer's parlance, "counseling" is thought of as including the giving of advice with respect to either completed or prospective transactions. "Counselling" is ordinarily not thought of as describing only the handling of contested matters. Thus using the plain words of the regulation as interpretative of the statute and using those plain words in their common meaning, the taxpayer is entitled to deduct fees for the type of services involved in this case.

Further, the government's restricted reading of § 212(3) tends to make meaningless the phrase "in connection with". That term was obviously intended to bring within the scope of the section all activities having a bearing on the "determination" of a tax and that would include counselling as to how a transaction will be treated for tax purposes.

The government relies heavily on the so-called "legislative history" of § 212(3) to support its arguments on this

issue. At page 46 of the government's brief, it quotes the report of the Ways and Means Committee (House Report No. 1337, 83rd Congress, Second Session, pages 29, A59) for the proposition that it was the intention of Congress to alow the deduction of tax legal fees only where they were paid with respect to contested matters.

The quoted portions of the Ways and Means Committee Report in no way indicate that deductions under the applicable sub-section are limited to those expenses incurred in connection with contested or litigated tax matters. The reference in the Committee Report to a "contested tax liability" is in the nature of an exemplification of the type of deduction allowed, rather than a limit on the deduction.

The changes in the tax laws brought about by the enactment of § 212(3) were designed to change the rule established by this court in *Lykes* v. *U. S.*, 343 US 118 (1952) where it was held that legal fees in connection with litigation of a gift tax issue were not deductible. See *McDonald, Deduction of Attorneys' Fees for Federal Income Tax Purposes, 103 Penna. L.R. 168, 194.* Since the purpose of the enactment of §212(3) was to change the rule of the *Lykes* case and since the *Lykes* decision involved a "contested tax liability", it is natural that the committee reports on this amendment should refer to a contested tax liability. There is no other significanee to that statement in the committee reports.

The argument of the government on this point runs directly counter to the decision of this Court in *Trust of Bingham* v. *Commissioner*, 325 US 365 (1945). There the Court held that fees paid "in connection with tax and other problems arising upon the expiration of the trust and relating to the final distribution of the trust fund among the three residuary legatees" were deductible under §23(a)(2) of the Internal Revenue Code of 1939 (corresponding to the provisions of §212(2) of the 1954 Code). This was despite the fact that in the *Bingham* case the fees were not associated with any contest, but merely with advice on tax matters. There is

no reason to believe that in enacting §212(3) of the 1954 Code Congress intended to restrict the deductions previously allowed by virtue of the *Bingham* decision. The committee report, cited and quoted from at page 46 of the government's brief, indicates §212(3) of the 1954 Code was a liberalizing provision intended to extend to the gift tax field the rules theretofore applicable in the income tax field.

The government, in support of its argument on the limited scope of §212(3), introduces (Govt. Br. 47) a part of a statement submitted by the Section of Taxation of the American Bar Association to the Senate Finance Committee. The government's brief quotes from a supplemental statement filed with the Senate Finance Committee in connection with hearings on H.R. 8300 and refers to the quoted language as something "pointed out at the Senate hearings on the new provision". The quoted statement reflects no more than the vague fears of an unknown author with respect to the interpretation of §212(3) of the 1954 Code.

Only in the most technical sense is it correct to refer to this quoted statement as having been given at a Senate Finance Committee hearing. On April 8, 1954, the then Chairman of the Section of Taxation of the American Bar Association appeared before the Senate Finance Committee and delivered a lengthy oral statement of the views of the Tax Section of the American Bar Association with respect to the House version of the bill which eventually became the Internal Revenue Code of 1954. 1 *Hearings before the Committee on Finance on the Internal Revenue Code of 1954*, 325. The oral statement covers 18 pages in the report of the hearings and at no place during his oral presentation did the witness refer to the section of the bill which became § 212(3) of the 1954 Code. At the conclusion of the oral statement, the witness requested and received permission to submit a written statement containing detailed comments with respect to the pending bill. This written statement, which is reprinted in small type, covered 152 pages of the report of the hearings.

There is not one scintilla of evidence to indicate that the short paragraph quoted at page 47 of the government's brief was ever considered by a single member of the Senate Finance Committee, much less by the other members of the Senate or by members of the House of Representatives. The matter was never discussed by the Committee so far as the report of the hearings shows. Under such circumstances it is impossible to do more than guess as to whether, if the small part of the statement of the Tax Section of the American Bar Association was considered, the consideration resulted in the committee determining that the language of the statute was broad enough to include the situations covered by the statement or whether the failure to change the House bill in this respect reflected an agreement that a more restrictive interpretation was the intention of the Committee. Either conclusion is equally compatible with the evidence at hand.

An attempt to use as evidence of Congressional intent a minuscule part of a 152 page written statement submitted to a Congressional committee *after* a hearing points up dramatically the reason for the salutary rule that a statement by a witness, before a Congressional committee, who is seeking the enactment of a particular statute, may not be considered in arriving at the intention of Congress. *Thomas* v. *F. B. Vandegrift & Co.*, 162 F. 645 (3d Circ. 1908), *Mutual Benefit Life Insurance Co.* v. *Duffy*, 295 F. 881 (D.C. N. J. 1924) affirmed 3 F. 2d 1020 (3d Circ. 1925) affirmed 272 US 613 (1926). This Court has held that, although reports of Congressional committees having charge of particular legislation may be used in arriving at the intention of Congress, debates in Congress are too unreliable to be used for that purpose. *Duplex Company* v. *Deering*, 254 US 443, 474-475 (1921); *Lapina* v. *Williams*, 232 US 78 (1914); and *U.S.* v. *Freight Association*, 166 US 290, 318-319 (1897). In the last cited case, in rejecting debates in Congress as appropriate sources of information regarding Congressional intent as exemplified in statutory language, the Court stated:

"The reason [for rejecting such materials] is that it is impossible to determine with certainty what construction was put upon an act by the members of a legislative body that passed it by resorting to the speeches of individual members thereof. Those who did not speak may not have agreed with those who did; and those who spoke might differ from each other; the result being that the only proper way to construe a legislative act is from the language used in the act, and, upon occasion by a resort to the history of the times when it passed.* * * *"

Surely if the statements of individual members of the Congress with respect to pending legislation are not to be relied upon as indicative of the intent of the majority of the Congress, it follows *a fortiori* that a single paragraph in a voluminous written statement submitted to a Congressional committee by a private citizen (and possibly never read by any member of Congress) should not be noticed in searching for that elusive thing known as "Congressional intent."

It is appropriate in this case, as it was in *Greenwood* v. *U.S.*, 350 US 366, 374 (1956) to apply "the canon of construction of the wag who said, when the legislative history is doubtful, go to the statute.* * * *".

When we "go to the statute", we find nothing to support the governments' principal argument with respect to the deduction of tax counsel fees. If the statute is in any respect ambiguous, that ambiguity has been resolved in the taxpayer's favor by the Treasury's Regulations which specifically provide for the deduction of "tax counsel" fees.

## B. THE FACT THAT THE TAX COUNSEL FEES WERE PAID TO THE ATTORNEY FOR THE WIFE OF THE TAXPAYER RATHER THAN TO THE TAXPAYER'S ATTORNEY IS IMMATERIAL FOR DEDUCTION PURPOSES

The Court of Claims disallowed the taxpayer's deduction of tax counsel fees paid to the attorney representing his

wife solely on the ground that the wife's attorney's services were not "directed to plaintiff's [Mr. Davis's'] tax problems". The Court of Claims concluded that under §212(3) of the 1954 Code only attorney's fees paid for services in connection with the payor-taxpayer's affairs are deductible. The Court of Claims cited no authority for this proposition. The words of the statute and of the applicable regulations do not support that proposition. There are no authorities known to taxpayer's counsel which support that proposition.

The government argues that a basis for the Court of Claims disallowance of the deduction for tax counsel fees is that as to Mr. Davis the payment was not for tax counsel fees, but rather was a payment which was "simply a part of his settlement with his wife—a liability which he assumed because he was advised that under Delaware practice it was customary for the husband to pay the wife's legal fees in connection with negotiations for a separation and property settlement agreement (R. 120)." (Govt. Br. 49). If the situation was as described in the just quoted statement from the government's brief, the taxpayers would be inclined to agree that the cases cited in the government's brief on this proposition are in point. For example, in *Interstate Transit Lines* v. *Commissioner,* 319 US 590 (1942), the Court denied a deduction to a parent corporation for the deficits of its wholly-owned subsidiary, even though under a contractual arrangement between the two corporations the parent was obligated to make good such deficit.

However, an analysis of the fundamentals of the law with respect to a husband's obligation to pay counsel fees to an attorney representing his wife shows that the government has based its argument on a wrong hypothesis, and as a result has cited in support of its argument cases completely inappropriate for this purpose.

It may be true that in some marital settlements a husband "agrees" to pay a certain amount to counsel who represented his wife. However, the agreement *per se* is not the

fundamental basis for the husband's liability. The fundamental basis for the husband's liability under such circumstances is the marital relationship. This liability would exist whether or not the husband expressly promised to pay such fees.

A husband has a legally enforceable duty to support his wife to the extent of his ability. 41 CJS, *Husband and Wife*, §15(a). It is well established as a part of that precept that a husband is liable to furnish "necessaries" to his wife. Id., §15(d). Services of an attorney to protect the interest of a wife in a matrimonial proceeding are recognized as "necessaries" for purposes of this general rule. 3 *Nelson's Divorce and Annulment* (Second Ed., 1945) §29.05, where it is stated:

> "* * * The legal basis of the award [counsel fees for the wife's attorney] in either case is the husband's obligation to supply necessaries, and it is almost universally held that the wife is entitled to defrayment of such expense where compelled, by her husband's commencement of suit or by his misconduct, to incur it, either in the original suit or on appeal.* * *"

The rule that attorney's services are "necessaries" has been extended to the point of requiring a husband to pay the fees of an attorney retained to defend the wife in connection with an indictment for the murder of their infant child. *Read* v. *Read,* 119 Col. 278, 202 P. 2d 953 (Sup. Ct. Col. 1949).

The general rule as to the right of a wife to have her husband pay necessary counsel fees in matters arising out of marital proceedings is well recognized in the state of Delaware, both by common law and by statute. 13 *Delaware Code Annotated* §1530; *du Pont* v. *du Pont,* 32 Del. Ch. 413, 431, 85 Atl. 2d 724, 733 (Sup. Ct., Del. 1951); and *Brown* v. *Brown,* 42 Del. 157 29 Atl. 2d 149, (Super. Ct. New Castle, 1942). The right of the wife to have her husband pay for necessaries survives even the separation of the spouses. *Fredd* v. *Eves,* 4 Del. (Harrington) 385, 387 (Super. Ct. 1846) and 41 *C.J.S. Husband and Wife* §15 (c)(2).

Thus, Mr. Davis's payment of the fees of his wife's attorney was not a matter of his voluntarily agreeing to assume a liability of his wife. The liability to pay his wife's attorney existed whether or not he voluntarily consented to such an arrangement. The payment was pursuant to a direct obligation running from Mr. Davis to the attorney. Accordingly, decisions dealing with contractual arrangements for assumption of a legal liability of another person are completely beside the point for purposes of analyzing this issue.

Mrs. Davis's counsel fees being legally enforceable claims against Mr. Davis, there is no reason for treating them for federal income tax purposes as any different from the legal fees payable by Mr. Davis to his own attorney. In analogous situations it has been repeatedly held that where one party is jointly liable with another party for payment of an item, the party actually making the payment of the item may deduct it. *Robert I. Ingalls, Jr.* v. *Patterson,* 158 F. Supp. 627 and *Ingalls Iron Works Co.* v. *Patterson,* 58-1 USTC para. 9241 [not officially reported] (D. Ala. 1958) (corporation entitled to deduct counsel fees of a stockholder bringing a derivative action, where under local law the corporation was liable for the payment of this fee, even though it had been incurred by a stockholder and not by the corporation.); *Thomas D. Conroy,* 17 TCM 21 (1958) (taxpayer entitled to deduct real estate taxes and mortgage interest with respect to real property titled in his daughter's name where beneficial ownership was in the father); *Al Jolson,* 3 TC 1184 (1944) Acq. 1944 CB 15 (taxpayer husband entitled to deduct California income tax assessed against him and his former wife with respect to his former wife's community income);[6] *Edward C. Kohlsaat,* 40 BTA 528, 534 (1939) Acq. 1939-2 CB 21 (taxpayer-husband entitled to deduct mortgage interest with respect to the real property conveyed to his wife and with respect to which he agreed to pay amounts to his wife to discharge the mortgage interest obligation); *F. C. Nicodemus, Jr.,* 26 BTA 125 (1925) Acq.

[6] To the same effect, see GCM 17570 1937-1 CB 193.

XIV-2 CB 16 (husband-taxpayer entitled to deduct all mortgage interest and real estate taxes paid by him in connection with real property owned by the taxpayer and his wife as tenants by the entireties;[7] and *IT 3304*, 1939 — 2 CB 158 (husband entitled to claim the entire amount of a casualty loss with respect to jointly held property damaged by a hurricane where the husband had paid all expenses in connection with repairing the damage).

The District Court and the Court of Appeals for the Fourth Circuit in the *Patrick* case (*U.S.* v. *Patrick*, 186 F. Supp. 48 (S. C., 1960) affirmed 288 F. 2d 292 (4th Circ., 1961) now pending before this Court (No. 256, October Term, 1961)), has allowed a taxpayer-husband to deduct counsel fees paid to an attorney representing his wife in connection with a marital property settlement. The *Patrick* case involves a deduction under §212(1) and (2) of the 1954 Code. Thus, the "force of precedent" favors the taxpayer on this issue.

The taxpayers agree that §212(3) does not allow husbands a deduction for payments made in discharging separation and property settlement obligations to a divorced wife. However, the taxpayers submit that under the plain wording of §212(3) a husband-taxpayer is entitled to deduct amounts paid by him "in connection with the determination, assessment or collection of any tax." Whether or not the husband agrees to pay such expenses in connection with a marital separation is beside the point. The inquiry is whether the husband-taxpayer paid these obligations by virtue of his status rather than by virtue of any negotiated agreement. In the instant case, the tax legal services furnished to the taxpayer's wife were furnished at a time when he was under an obligation to supply her with necessaries, including legal services.

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[7] To the same effect, *William R. Tracy*, 25 BTA 1055, 1061 (1932) reversed on another point 70 F. 2d 93 (6th Circ. 1934); *IT 3785*, 1946-1 CB 98 and *GCM 15530* XIV-2 CB 107.

## CONCLUSION

The decision below should be affirmed on the first issue (No. 190) and reversed on the second issue (No. 268).

Respectfully submitted,

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FILE COPY



No. 190

# In the Supreme Court of the United States

October Term, 1961

[illegible], Petitioner

v.

[illegible], et al.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF [illegible]

BRIEF FOR THE UNITED STATES

Archibald Cox,
Solicitor General,
[illegible],
Assistant Attorney General,
[illegible],
[illegible],
Attorneys,
Department of Justice, Washington 25, D.C.

# In the Supreme Court of the United States

October Term, 1961

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No. 190

United States, petitioner

*v.*

Thomas Crawley Davis, et al.

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*ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

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## REPLY BRIEF FOR THE UNITED STATES

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### I

### THE MARITAL OBLIGATIONS DISCHARGED IN THE "MESTA" AND "HALLIWELL" CASES WERE OF THE SAME NATURE AS THOSE INVOLVED IN THE INSTANT CASE

Taxpayer argues (Br. 14–16) that *Commissioner* v. *Mesta,* 123 F. 2d 986 (C.A. 3d), certiorari denied, 316 U.S. 695, and *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C.A. 2d), certiorari denied, 319 U.S. 741, are not authorities in point on the ground that there the transfers were made in discharge of obligations to support and were not transfers by way of division of common property of the spouses, which taxpayer asserts is the case here. Both facets of this contention seem to us incorrect.

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In *Mesta* and *Halliwell* the transfers were not merely in consideration of discharge of support rights but of discharge of all marital rights against the respective husbands' property. Thus, in *Mesta,* 42 B.T.A. 933, 934–935:

> the delivery of the securities and property mentioned above by him was "in full settlement and satisfaction of all claims and demands on the part of Mrs. Mesta for her maintenance and support, and in lieu of all rights which she may now have, or hereafter acquire, against the property of Mr. Mesta, as wife, widow, or in any manner arising out of or resulting from the relationship of husband and wife * * *." She also released Mesta, his heirs, executors, administrators and assigns, from all claims for support and maintenance and from all rights, interests, claims, demands or preferences in or against him or his estate that she might have as wife, widow, or otherwise.

Again in *Halliwell* the parties agreed that if the husband died pending the divorce action, the securities and cash specified in the agreement were to be delivered to the wife "in lieu of any and all statutory and other rights in and to petitioner's estate." Additionally the wife "executed a release in which she released petitioners, his executors, administrators, and estate from all of her rights to share in his property at his death." (44 B.T.A. 740, 743.)

Moreover, in the present case all of the transfers were made in consideration for the release of all rights she had against him both by way of support

and as against any of his property.[1] As the Court below found, all of the property involved in the property settlement agreement was owned by Mr. Davis (R. 115) and as discussed in our main brief (pp. 22–23) under Delaware law, with the possible exception of dower, the wife had no property interest in any of the property owned by the husband. She could not have prevented him, for example, from selling the duPont stock, and she had no specific right in any of his property. While the agreement purports to make "division" (R. 93) of certain items of property including the stock and impose certain other obligations on him for her maintenance and support, use of the word "division" in the agreement is a legal misnomer. The term does not describe what transpired under the Delaware law except in a loose, figurative and nonlegal sense. The wife had no property involved in the settlement agreement which she could divide with him; on the contrary, as the Court found,

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[1] Paragraph 13 of the settlement agreement (R. 97) reads as follows:

> 13. The parties hereto and each of them covenant that this agreement is and shall be a complete and final settlement of all claims of every nature and kind between them. Upon performance of husband's covenants and undertakings under this agreement, the wife hereby waives, releases and relinquishes unto the husband all rights that she might otherwise have to any of the property of the husband and to any claim for support or maintenance for herself and their minor child, and that she will not incur or contract any debt or obligation on the husband's credit and that she will keep the husband and his estate indemnified against and from all debts and liabilities to be contracted or incurred by her with all actions, proceedings, claims and demands, costs, damages and expenses whatsoever in respect to such liabilities or any of them.

all of the property involved was owned by him. Indeed, property settlements and continuing periodical payments are but alternative methods of settling the same obligations arising from the marital relationship. This is illustrated in the present agreement by the provision that "for her maintenance and support" (R. 95) he agrees to pay her a sum of money equivalent to the dividend paid to holders of duPont stock during the period before he shall have transferred the entire 1,000 shares to her. Similarly, the stock and its dividends, once he did transfer it to her, represented satisfaction *pro tanto* of the same obligation and indeed of all obligations arising from the marital relationship.

Finally, the court below clearly considered *Mesta* and *Halliwell* as authorities in point, although it refused to follow them.[2] (R. 108–109.)

## II

### THE GOVERNMENT IS NOT INTRODUCING A DIVERGENCE IN THE TAX LAWS BETWEEN COMMON-LAW AND COMMUNITY-PROPERTY JURISDICTIONS

Taxpayer argues that the Government is asking the Court "to introduce into the tax laws a serious divergence of treatment" (Br. 9) between common-law and community-property jurisdictions. Such diver-

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[2] Thus, the opinion below states (R. 108–109):

The result is that we are faced with two precedents pointing in opposite directions and an attempt to distinguish the two is impossible.

Since there is no clear ground for distinguishment between the rule of the *Mesta-Halliwell* cases and the *Marshman* case, it behooves us to decide which rule is the correct one in the premises. * * *

gencies have long existed, however, and are the product simply of the different "property" rights created by the laws of the several states. If it is thought to be undesirable to have tax consequences turn upon such differences, the remedy lies with Congress, and not with the courts. Congress has in fact acted to remove some of the divergencies in tax consequences between common-law and community-property states, but it has by no means removed all of them.[3] Among the areas in which Congress has been content to allow tax consequences to turn upon state law is that of property transfers incident to a divorce, for although the rule objected to by the taxpayer was adopted in the *Mesta* and *Halliwell* cases over twenty years ago, Congress has not seen fit to change it. That the results here, as in many other areas of the tax law, may turn upon differences of property law among the

[3] Although Congress removed one of the most basic discrepancies by permitting spouses in common-law states to file joint returns with "income-splitting" for tax computation purposes, there remain, even in the limited area of the treatment of current items of income and expenses, substantial additional benefits available to taxpayers in community-property states. Because of the wife's "ownership" of one-half of the community income, community-property spouses need not file joint returns to gain the benefits of income-splitting and are therefore free to file separate returns when it is advantageous to do so—*e.g.*, to avoid joint liability; to permit deduction of capital losses up to $2,000 rather than $1,000 (Section 1211); or to lower the amount (3% of adjusted gross income) which medical expenses must exceed to be deductible (Section 213). Other benefits that would not be available in a common-law state if the husband owned all the income include, for example, a maximum dividend exclusion of $100 rather than $50 (Section 116) and a maximum retirement income credit of $480 rather than $240 (Section 37).

several states is not, by itself, a sufficient reason for this Court to reject those long-standing decisions.

## III

### IF THERE WAS A TAXABLE EXCHANGE, THE CONSIDERATION RECEIVED SHOULD BE MEASURED BY THE VALUE OF THE STOCK ON THE DATE OF THE TRANSFER

Taxpayer in his brief here makes two contentions, not raised below, bearing upon the measure of the consideration which he received for the duPont stock transferred in March 1955.

First, he urges (Br. 21–22) that, if the market value of the duPont stock is to be accepted as the equivalent of the rights released by his wife, the relevant value is its market value on the date of the agreement (November 1954) and not, as the Government claims, the date when the stock was transferred to Mrs. Davis (March 21, 1955). He states that the market value in November 1954 was below his basis for the stock and concludes that he therefore suffered a loss, not a gain, from the transaction. That this is a wholly new argument in this Court is shown by the absence from the record of any proof of the market value of the stock in November 1954.

Superficially, it might be possible to follow the equivalence of value rationale the further step and say that, since the parties here could not know the future price of duPont stock, the value they assigned to the marital rights should be the value on the day they signed the agreement. In this instance as in others, however, we suggest that any rationale developed should provide, above all else, a workable and

understandable rule consistent with the main body of tax law. Tax solutions, like the Law Merchant, should, when possible, contribute to ease of administration by taxpayers and the Government.

In all other cases under the Internal Revenue Code when a taxable exchange actually takes place on a given date, the property given up and the property received are valued on that date, even though the exchange may be pursuant to an earlier binding agreement. The date of exchange was used in the *Mesta* and *Halliwell* cases,[4] and was not contested by the parties. The Commissioner's selection of that date was similarly not contested below by the taxpayer in this case.

The administrative necessity for that rule can be seen by a more common example of an instance where the value of the property received is measured by the property given up. If, in a taxable exchange, a

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[4] In *Mesta* (123 F. 2d 986, 42 B.T.A. 933) the property settlement agreement was signed by the husband on March 22, 1935, and by the wife on April 13, 1935. The husband agreed to deliver 5,200 shares of stock and certain personal property. The contract contained provisions whereby the parties would respectively release and discharge each other from all claims or demands. On April 17, 1935, the husband delivered the stock. The court took the fair market value of the stock on the date of the transfer ($156,975) less the cost ($7,574) as the measure of the husband's gain.

In *Halliwell* (131 F. 2d 642, 44 B.T.A. 740), the parties agreed to a property settlement on March 16, 1938, on which date the wife executed a release of the husband's marital obligations. The property (securities) was transferred on July 16, 1938. Although it appears from the Board of Tax Appeals' opinion that the value of the securities was the same on both dates (44 B.T.A. at 743–744), making the question unimportant, the court of appeals in terms referred to the value on the date of delivery as controlling (131 F. 2d at 643).

taxpayer corporation exchanges stock listed on a national exchange for stock in a closely held corporation for which there is no established market price, all would agree that the gain to the taxpayer may be measured by the value of the stock given up. Yet it has never been suggested heretofore that any value other than that on the closing date should be used. Nor would any other date be feasible in such intercorporate exchanges. If the date of "agreement" were to be used, there would usually remain questions in varying factual situations as to whether the date of "agreement" was the date of the initial agreement of the negotiators, the date it was approved by the directors, the date it was approved by the shareholders, the date on which a regulatory agency approved the proposed exchange, the date a favorable tax ruling upon which the exchange was contingent was received, *etc.* Much the same problem exists in the case of a marital settlement where the property understanding is quickly reached but dispute over custody of the children, formal divorce proceedings or some other important, but not necessarily financial, consideration makes it difficult to pin down the precise date of final agreement. Since the date of exchange is readily ascertainable without any confusion between formal and actual agreement and has been fixed by the parties themselves for the mutual transfer of equivalent obligations, it should be the determinative date for valuation of the properties exchanged. Such a solution, giving to the time of physical delivery and receipt prime significance in measuring rights and

liabilities, has the virtue of simplicity and precision which no alternative solution would afford.

The second contention raised by taxpayer for the first time on brief here (p. 22) is the "intriguing and serious question as to when this consideration was received." Suggestion is made that the consideration is received not in the year of transfer (1955) but rather in 1954 (the year of agreement), in 1956 (the year of the second transfer of 500 shares of duPont stock), or in 1964 (when the last of the periodic payments is to be made).

Again resort must be had to a workable rule. The gain could not have been taxed in 1954 since the shares which would be used to fulfill the obligation were not yet identified. The selection of 1956 would also result in a bunching of income in one year. The selection of 1964 would cause an unreasonable postponement since Mr. Davis will have had the full benefit of the release from marital obligations for many years prior thereto.

The ratable realization of gain accomplished by matching the income received with the property surrendered is a necessary corollary to the rule of equivalence of value. Moreover it comports with the reality of the situation. Petitioner could have sold these shares for some $7,500 more than they cost him. Instead he used the shares to satisfy his obligation to his wife. Since he received the benefit of conferring the full fair market value on her in 1955, he

should be taxed in that year rather than in a later year when he has disposed of another lot of stock.

Respectfully submitted.

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MARCH 1962.

U.S. GOVERNMENT PRINTING OFFICE 1962

# SUPREME COURT OF THE UNITED STATES

Nos. 190 and 268.—October Term, 1961.

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| United States, Petitioner, 190 v. Thomas Crawley Davis et al. Thomas Crawley Davis et al., Petitioners, 268 v. United States. | On Writs of Certiorari to the United States Court of Claims. |

[June 4, 1962.]

Mr. Justice Clark delivered the opinion of the Court.

These cases involve the tax consequences of a transfer of appreciated property by Thomas Crawley Davis [1] to his former wife pursuant to a property settlement agreement executed prior to divorce, as well as the deductibility of his payment of her legal expenses in connection therewith. The Court of Claims upset the Commissioner's determination that there was taxable gain on the transfer but upheld his ruling that the fees paid the wife's attorney were not deductible. 287 F. 2d 168. We granted certiorari on a conflict in the Courts of Appeals and the Court of Claims on the taxability of such transfers.[2] 368 U. S. 813. We have decided that the taxpayer did have a taxable gain on the transfer and that the wife's attorney's fees were not deductible.

In 1954 the taxpayer and his then wife made a voluntary property settlement and separation agreement calling

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[1] Davis' present wife, Grace Ethel Davis, is also a party to these proceedings because a joint return was filed in the tax year in question.

[2] The holding in the instant case is in accord with *Commissioner* v. *Marshman,* 279 F. 2d 27 (C. A. 6th Cir. 1960), but is contra to the holdings in *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C. A. 2d Cir. 1942), and *Commissioner* v. *Mesta,* 123 F. 2d 986 (C. A. 3d Cir. 1941).

for support payments to the wife and minor child in addition to the transfer of certain personal property to the wife. Under Delaware law all the property transferred was that of the taxpayer, subject to certain statutory marital rights of the wife including a right of intestate succession and a right upon divorce to a share of the husband's property.[3] Specifically as a "division in settlement of their property" the taxpayer agreed to transfer to his wife, *inter alia,* 1,000 shares of stock in the E. I. du Pont de Nemours & Co. The then Mrs. Davis agreed to accept this division "in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy) . . . ." Pursuant to the above agreement which had been incorporated into the divorced decree, one-half of this stock was delivered in the tax year involved, 1955, and the balance thereafter. Respondent's cost basis for the 1955 transfer was $74,775.37, and the fair market value of the 500 shares there transferred was $82,250. The taxpayer also agreed orally to pay the wife's legal expenses, and in 1955 he made payments to the wife's attorney, including $2,500 for services concerning tax matters relative to the property settlement.

I.

The determination of the income tax consequences of the stock transfer described above is basically a two-step analysis: (1) Was the transaction a taxable event? (2) If so, how much taxable gain resulted therefrom? Originally the Tax Court (at that time the Board of Tax Appeals) held that the accretion to property transferred pursuant to a divorce settlement could not be taxed as capital gain to the transferor because the amount realized

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[3] 12 Del. Code Ann. (Supp. 1960) § 512; 13 Del. Code Ann. § 1531. In the case of realty, the wife in addition to the above has rights of dower. 12 Del. Code Ann. §§ 502, 901, 904, 905.

by the satisfaction of the husband's marital obligations was indeterminable and because, even if such benefit were ascertainable, the transaction was a nontaxable division of property. *Mesta* v. *Commissioner,* 42 B. T. A. 933 (1940); *Halliwell* v. *Commissioner,* 44 B. T. A. 740 (1941). However, upon being reversed in quick succession by the Courts of Appeals of the Third and Second Circuits, *Commissioner* v. *Mesta,* 123 F. 2d 986 (C. A. 3d Cir. 1941); *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C. A. 2d Cir. 1942), the Tax Court accepted the position of these courts and has continued to apply these views in appropriate cases since that time. *Hall* v. *Commissioner,* 9 T. C. 53 (1947); *Patino* v. *Commissioner,* 13 T. C. 816 (1949); *Estate of Stouffer,* 30 T. C. 1244 (1958); *King* v. *Commissioner,* 31 T. C. 108 (1958); *Marshman* v. *Commissioner,* 31 T. C. 269 (1958). In *Mesta* and *Halliwell* the Courts of Appeals reasoned that the accretion to the property was "realized" by the transfer and that this gain could be measured on the assumption that the relinquished marital rights were equal in value to the property transferred. The matter was considered settled until the Court of Appeals for the Sixth Circuit, in reversing the Tax Court, ruled that, although such a transfer might be a taxable event, the gain realized thereby could not be determined because of the impossibility of evaluating the fair market value of the wife's marital rights. *Commissioner* v. *Marshman,* 279 F. 2d 27 (1960). In so holding that court specifically rejected the argument that these rights could be presumed to be equal in value to the property transferred for their release. This is essentially the position taken by the Court of Claims in the instant case.

II.

We now turn to the threshold question of whether the transfer in issue was an appropriate occasion for taxing the accretion to the stock. There can be no doubt

that Congress, as evidenced by its inclusive definition of income subject to taxation, *i. e.*, "all income from whatever source derived, including . . . [g]ains derived from dealings in property," [4] intended that the economic growth of this stock be taxed. The problem confronting us is simply *when* is such accretion to be taxed. Should the economic gain be presently assessed against taxpayer, or should this assessment await a subsequent transfer of the property by the wife? The controlling statutory language, which provides that gains from dealings in property are to be taxed upon "sale or other disposition," [5] is too general to include or exclude conclusively the transaction presently in issue. Recognizing this, the Government and the taxpayer argue by analogy from transactions more easily classified as within or without the ambient of taxable events. The taxpayer asserts that the present disposition is comparable to a nontaxable division of property between two co-owners,[6] while the

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[4] Internal Revenue Code of 1954 § 61 (a).

[5] Internal Revenue Code of 1954 §§ 1001, 1002.

[6] Any suggestion that the transaction in question was a gift is completely unrealistic. Property transferred pursuant to a negotiated settlement in return for the release of admittedly valuable rights is not a gift in any sense of the term. To intimate that there was a gift to the extent the value of the property exceeded that of the rights released not only invokes the erroneous premise that every exchange not precisely equal involves a gift but merely raises the measurement problem discussed in Part III, *infra*, p. —. Cases in which this Court has held transfers of property in exchange for the release of marital rights subject to gift taxes are based not on the premise that such transactions are inherently gifts but on the concept that in the contemplation of the gift tax statute they are to be taxed as gifts. *Merrill* v. *Fahs*, 324 U. S. 308 (1945); *Commissioner* v. *Wemyss*, 324 U. S. 303 (1945); see *Harris* v. *Commissioner*, 340 U. S. 106 (1950). In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes. See *Farid-Es-Sultaneh* v. *Commissioner*, 160 F. 2d 812 (C. A. 2d Cir. 1947).

Government contends it more resembles a taxable transfer of property in exchange for the release of an independent legal obligation. Neither disputes the validity of the other's starting point.

In support of his analogy the taxpayer argues that to draw a distinction between a wife's interest in the property of her husband in a common-law jurisdiction such as Delaware and the property interest of a wife in a typical community property jurisdiction would commit a double sin; for such differentiation would depend upon "elusive and subtle casuistries which . . . possess no relevance for tax purposes," *Helvering* v. *Hallock,* 309 U. S. 106, 118 (1940), and would create disparities between common-law and community property jurisdictions in contradiction to Congress' general policy of equality between the two. The taxpayer's analogy, however, stumbles on its own premise, for the inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership. The wife has no interest—passive or active—over the management or disposition of her husband's personal property. Her rights are not descendable, and she must survive him to share in his intestate estate. Upon dissolution of the marriage she shares in the property only to such extent as the court deems "reasonable." 13 Del. Code Ann. § 1531 (a). What is "reasonable" might be ascertained independent of the extent of the husband's property by such criteria as the wife's financial condition, her needs in relation to her accustomed station in life, her age and health, the number of children and their ages, and the earning capacity of the husband. See, *e. g., Beres* v. *Beres,* 52 Del. 133, 154 A. 2d 384 (1959).

This is not to say it would be completely illogical to consider the shearing off of the wife's rights in her husband's property as a division of that property, but we believe the contrary to be the more reasonable construc-

tion. Regardless of the tags, Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof. In the present context the rights of succession and reasonable share do not differ significantly from the husband's obligations of support and alimony. They all partake more of a personal liability to the husband than a property interest of the wife. The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a division of property by co-owners. Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences between community property and common-law systems. *E. g., Poe* v. *Seaborn*, 282 U. S. 101 (1930). To be sure Congress has seen fit to alleviate this disparity in many areas, *e. g.,* Revenue Act of 1948, 62 Stat. 110, but in other areas the facts of life are still with us.

Our interpretation of the general statutory language is fortified by the long-standing administrative practice as sounded and formalized by the settled state of law in the lower courts. The Commissioner's position was adopted in the early 40's by the Second and Third Circuits and by 1947 the Tax Court had acquiesced in this view. This settled rule was not disturbed by the Court of Appeals for the Sixth Circuit in 1960 or the Court of Claims in the instant case, for these latter courts in holding the gain indeterminable assumed that the transaction was otherwise a taxable event. Such unanimity of views in support of a position representing a reasonable construction of an ambiguous statute will not lightly be put aside. It is quite possible that this notorious construction was relied upon by numerous taxpayers as well as the

Congress itself, which not only refrained from making any changes in the statutory language during more than a score of years but re-enacted this same language in 1954.

III.

Having determined that the transaction was a taxable event, we now turn to the point on which the Court of Claims balked, *viz.*, the measurement of the taxable gain realized by the taxpayer. The Code defines the taxable gain from the sale or disposition of property as being the "excess of amount realized therefrom over the adjusted basis . . . ." I. R. C. (1954) § 1001 (a). The "amount realized" is further defined as "the sum of any money received plus the fair market value of the property (other than money) received." I. R. C. (1954) § 1001 (b). In the instant case the "property received" was the release of the wife's inchoate marital rights. The Court of Claims, following the Court of Appeals for the Sixth Circuit, found that there was no way to compute the fair market value of these marital rights and that it was thus impossible to determine the taxable gain realized by the taxpayer. We believe this conclusion was erroneous.

It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged. There was no evidence to the contrary here. Absent a readily ascertainable value it is accepted practice where property is exchanged to hold, as did the Court of Claims in *Philadelphia Park Amusement Co.* v. *United States*, 126 F. Supp. 184, 189 (1954), that the values "of the two properties exchanged in an arm's-length transaction are either equal in fact, or are presumed to be equal." Accord, *United States* v. *General Shoe Corp.*, 282 F. 2d 9 (C. A. 6th Cir. 1960); *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310 (C. A. 2d Cir. 1943). To be sure there is much to

be said of the argument that such an assumption is weakened by the emotion, tension and practical necessities involved in divorce negotiations and the property settlements arising therefrom. However, once it is recognized that the transfer was a taxable event, it is more consistent with the general purpose and scheme of the taxing statutes to make a rough approximation of the gain realized thereby than to ignore altogether its tax consequences. Cf. *Helvering* v. *Safe Deposit & Trust Co.*, 316 U. S. 56, 67 (1942).

Moreover, if the transaction is to be considered a taxable event as to the husband, the Court of Claims' position leaves up in the air the wife's basis for the property received. In the context of a taxable transfer by the husband,[7] all indicia point to a "cost" basis for this property in the hands of the wife.[8] Yet under the Court of Claims' position her cost for this property, *i. e.*, the value of the marital rights relinquished therefor, would be indeterminable, and on subsequent disposition of the property she might suffer inordinately over the Commissioner's assessment which she would have the burden of proving erroneous, *Commissioner* v. *Hansen*, 360 U. S. 446, 468 (1959). Our present holding that the value of these rights is ascertainable eliminates this problem; for the

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[7] Under the present administrative practice, the release of marital rights in exchange for property or other consideration is not considered a taxable event as to the wife. For a discussion of the difficulties confronting a wife under a contrary approach see Taylor and Schwartz, Tax Aspects of Marital Property Agreements, 7 Tax L. Rev. 19, 30 (1951); Comment, The Lump Sum Divorce Settlement as a Taxable Exchange, 8 U. C. L. A. L. Rev. 593, 601-602 (1961).

[8] Section 1012 of the Internal Revenue Code of 1954 provides that: "The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)."

same calculation that determines the amount received by the husband fixes the amount given up by the wife, and this figure, *i. e.*, the market value of the property transferred by the husband, will be taken by her as her tax basis for the property received.

Finally, it must be noted that here, as well as in relation to the question of whether the event is taxable, we draw support from the prior administrative practice and judicial approval of that practice. See p. —, *supra.* We therefore conclude that the Commissioner's assessment of a taxable gain based upon the value of the stock at the date of its transfer has not been shown erroneous.[9]

## IV.

The attorney-fee question is much simpler. It is the customary practice in Delaware for the husband to pay both his own and his wife's legal expenses incurred in the divorce and the property settlement. Here petitioner paid $5,000 of such fees in the taxable year 1955 earmarked for tax advice in relation to the property settlement. One-half of this sum went to the wife's attorney. The taxpayer claimed that under § 212 (3) of the 1954 Code, which allows a deduction for the "ordinary and necessary expenses paid . . . in connection with the determination, collection, or refund of any tax," he was entitled to deduct the entire $5,000. The Court of Claims allowed the $2,500 paid taxpayer's own attorney but denied the like amount paid the wife's attorney. The sole question here is the deductibility of the latter fee; the Government did not seek review of the amount taxpayer paid his own attorney, and we intimate no decision on that point. As to the deduction of the wife's fees, we read the statute, if applicable to this type of tax expense,

[9] We do not pass on the soundness of the taxpayer's other attacks upon this determination, for these contentions were not presented to the Commissioner or the Court of Claims.

to include only the expenses of the taxpayer himself and not those of his wife. Here the fees paid her attorney do not appear to be "in connection with the determination, collection, or refund" of any tax of the taxpayer. As the Court of Claims found, the wife's attorney "considered the problems from the standpoint of his client alone. Certainly then it cannot be said that . . . [his] advice was directed to plaintiff's tax problems . . . ." 287 F. 2d, at 171. We therefore conclude, as did the Court of Claims, that those fees were not a deductible item to the taxpayer.

*Reversed in part and affirmed in part.*

MR. JUSTICE FRANKFURTER took no part in the decision of these cases.

MR. JUSTICE WHITE took no part in the consideration or decision of these cases.

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IN THE

# Supreme Court of the United States

October Term, 1961.

No. 268.

THOMAS CRAWLEY DAVIS and
GRACE ETHEL DAVIS,
*Petitioners,*
*v.*
UNITED STATES.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

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IN THE

# Supreme Court of the United States.

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October Term, 1961.

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No.

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THOMAS CRAWLEY DAVIS AND
GRACE ETHEL DAVIS,
*Petitioners,*

*v.*

UNITED STATES.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

The petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Claims in this case.

## OPINION BELOW.

The opinion of the Court of Claims (Appendix, *infra*, pp. 9-35) is reported at 287 F. (2d) 168.

## JURISDICTION.

The judgment of the United States Court of Claims was entered on April 14, 1961 (Appendix, *infra*, p. 36). By order of the Chief Justice, dated June 1, 1961, the time for filing a petition for a writ of certiorari was extended to and including July 29, 1961. The jurisdiction of this Court is invoked under 28 U. S. C. 1255.

## QUESTION PRESENTED.

Whether for federal income tax purposes a taxpayer is entitled to deduct fees paid to his wife's attorney for services in connection with tax matters.

## STATUTE INVOLVED.

Internal Revenue Code of 1954 (26 U. S. C., Section 212):

Section 212. *Expenses for Production of Income.* In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

* * *

(3) In connection with the determination, collection, or refund of any tax.

## STATEMENT.

The material facts with respect to the question presented as found by the Court of Claims (Appendix, *infra*, pp. 21-35) may be summarized as follows:

On March 1, 1941, Thomas Crawley Davis (taxpayer) married Alice M. Davis [1] (Appendix, *infra*, p. 21). During 1953 Alice M. Davis requested the taxpayer to transfer to her one-half of his property, including 1,500 shares of duPont stock. She did not at that time request a divorce or separation. The taxpayer rejected these property demands (Appendix, *infra*, p. 26).

By December 1953 the relations between the taxpayer and Alice M. Davis had become very strained. Her de-

1. Petitioner, Grace Ethel Davis, is the taxpayer's present wife. She is a party to this proceding because she and her husband filed a joint federal income tax return for the calendar year 1955.

mands for a property division had become more insistent, and in June 1954 Mrs. Davis consulted an attorney, James R. Morford, Esquire, of Wilmington concerning her marital problems and the matter of a property settlement. The taxpayer at first declined to discuss the matter of a separation or property settlement, but later retained an attorney, H. Albert Young, Esquire, of Wilmington, Delaware, to represent him (Appendix, *infra*, pp. 26-27).

The taxpayer's attorney was not successful in an attempt to accomplish a reconciliation of the taxpayer and Alice M. Davis (Appendix, *infra*, p. 27). The parties thereupon entered into a series of negotiations regarding: (1) a division of the property of the parties, (2) the manner of transferring certain property to Mrs. Davis, and (3) the manner of arranging for the discharge of the taxpayer's obligations for support and maintenance of Alice M. Davis and their minor child (Appendix, *infra*, pp. 27-30).

Throughout the negotiations regarding the separation and property settlement both Mr. Young (representing taxpayer) and Mr. Morford (as attorney for Alice M. Davis) considered federal income and gift tax consequences flowing from various phases of the proposals made during the course of the negotiations (Appendix, *infra*, pp. 31-32). The tax problems involved were extensive and were complicated by the fact that the Internal Revenue Code of 1954 had only recently accomplished a complete revision and recodification of the federal tax statutes (Appendix, *infra*, p. 12).

During the negotiations, both attorneys advised the taxpayer that it was the practice, in conformity with Delaware law, that the husband pay the fees of the wife's attorney in connection with negotiations for a separation and property settlement. As a result of this advice, the taxpayer throughout understood that he was expected to pay the fees of Mrs. Davis' attorney and he agreed to do so (Appendix, *infra*, p. 32). The negotiations between

the taxpayer, Alice M. Davis, and their respective attorneys culminated in the execution of a November 4, 1954 separation and property settlement agreement (Appendix, *infra*, p. 28).

On December 16, 1954 Mr. Morford submitted to the taxpayer a bill for $5,000.00, identified as "to professional services rendered in connection with tax matters involved in the matter of Alice M. Davis v. T. Crawley Davis" (Appendix, *infra*, pp. 32-33). Of this bill taxpayer paid $2,500.00 on November 14, 1954, and the balance on January 27, 1955 (Appendix, *infra*, p. 33).

It is deductibility of the last payment which is the matter in controversy.

The taxpayer deducted in his 1955 federal income tax return the amount of $2,500.00 paid to Mr. Morford for legal services in connection with tax matters (Appendix, *infra*, p. 34). In connection with the audit of the petitioners' 1955 tax return, an agent of the Internal Revenue Service disallowed that deduction and asserted a deficiency which was duly paid by the taxpayer (Appendix, *infra*, p. 34).

On April 8, 1958 the petitioners filed a claim for refund of federal income taxes for the year 1955 on the basis, *inter alia*, that the January 1955 payment of $2,500.00 to Mr. Morford on account of his bill for legal services in connection with tax matters was deductible under Section 212(3) of the Internal Revenue Code of 1954 (26 U. S. C. 212(3)) (Appendix, *infra*, p. 35).

On September 28, 1953, the District Director of Internal Revenue for Delaware notified petitioners of the disallowance of their claim for refund for the year 1955 (Appendix, *infra*, p. 35). On November 20, 1958, petitioners filed a petition in the Court of Claims seeking refund of 1955 federal income tax based in part upon the failure of the Internal Revenue Service to allow the deduction of $2,500.00 paid to Mr. Morford for tax legal services (R. 1-18). Jurisdiction

of the Court of Claims was based upon Section 1491 of the Judicial Code and Judiciary (28 U. S. C. 1491).

The Court of Claims decided that the taxpayer was entitled to deduct tax legal fees paid to Mr. Young (the attorney representing the taxpayer) but that he was not entitled to deduct tax legal fees which he was required to pay to Mr. Morford (his wife's attorney). The sole basis for the Court of Claims decision to that effect was the fact that Mr. Morford was representing the taxpayer's wife rather than the taxpayer (Appendix, *infra*, p. 13).

There were other issues involved in the Court of Claims proceeding and as to one phase of the decision the Government has petitioned for certiorari (October Term, 1961, No. 190). The petitioners in this proceeding have filed a brief opposing the grant of the Government's petition for certiorari.

## REASONS FOR GRANTING THE WRIT.

The decision of the Court of Claims holding that the taxpayer is not entitled to deduct tax legal fees he was required to pay to Mr. Morford is in direct conflict with the decision of the Court of Appeals for the Fourth Circuit in *Patrick v. United States*, 288 F. (2d) 292, 296 (March 27, 1961).

In the *Patrick* case the taxpayer paid legal fees to an attorney representing his wife for various services in connection with the negotiation of a property settlement incident to a divorce. The court held that a part of such legal fees paid by the husband were deductible for federal income tax purposes as expenses for the "management, conservation, or maintenance of property held for the production of income." The Court of Appeals rejected the government's contention that the fees paid to the attorney for the taxpayer's wife were not deductible even though they partook of the same characterization as those paid to the attorney for the husband. The Court of Appeals stated on this point:

"The Government further contends, however, that even though the legal fees incurred by the taxpayer in maintaining and conserving his income-producing property are deductible under Code Section 212(2), the fees paid his wife's attorneys are under no circumstances deductible. The taxpayer's liability for his legal fees and the legal fees for his wife would not have been incurred except for the necessity of the long and extended negotiations culminating in the preservation, maintenance and conservation of the taxpayer's income-producing property. They were incurred for that purpose and that purpose only.

"The only test of deductibility provided for in the statute is whether or not the expenses were reasonable and proximately related to the management, conservation and maintenance of income-producing property. It makes no difference to whom they are paid."

On this point there is no distinction between the situation of the taxpayer in the *Patrick* case and the taxpayer in this case. Both paid counsel fees to attorneys representing their wives. In both cases the payment of such counsel fees was pursuant to a legal obligation imposed upon the taxpayer. In both cases the attorney for the taxpayer's wife was retained to represent her interests. In both, the expenses were incurred in connection with problems associated with the matter of dividing the husband's property with his wife.

As was true in the *Patrick* case, the tax legal fees paid by Mr. Davis were directly associated with the matter of the negotiation of a separation and property settlement agreement. Mr. Davis was not a mere volunteer paying tax legal fees of a third party. They were direct obligations of his and were of the type clearly covered by the statute, i.e., expenses in connection with "the determination, collection, or refund of any tax."

The general rule as to the right of a wife to have her husband pay necessary counsel fees in matters arising out of marital proceedings is well recognized in the State of Delaware, both by common law and by statute. 13 Del. Code Ann., Section 1530; *duPont v. duPont*, 85 Atl. (2d) 724, 733 (Supreme Court, Delaware, 1951); and *Brown v. Brown*, 29 Atl. (2d) 149 (Superior Court, Delaware, New Castle, 1942).

The decision of the Court of Claims that Mr. Davis is not entitled to deduct tax legal fees merely because they were paid to the attorney representing his wife rather than to the attorney representing him is inconsistent with the positions taken by the courts and the Commissioner of Internal Revenue in analogous situations. C.g. see *Robert I. Ingalls, Jr. v. Patterson*, 158 F. Supp. 627, and *Ingalls Iron Works Company v. Patterson*, 58-1 U .S. T. C., par. 9241 (not otherwise reported) (D. Ala. 1958) (legal fees of a stockholder's attorney paid by the corporation where under local law in derivative stockholders' suits the corporation was obligated to bear such expense); *Thomas D. Conroy*, 17 T. C. M. 21 (1958) (mortgage interest and taxes paid the beneficial owner deductible by him even though legal title, and hence primary obligation for these items, was in his daughter); *Al Jolson*, 3 T. C. 1184 (1944), Acq. 1944 C. B. 15 (husband entitled to deduct California income tax assessed against his former wife) (to the same effect, see G. C. M. 17570, 1937-1 C. B. 193); *Edward C. Kohlsaat*, 40 B. T. A. 528, 534 (1939), Acq. 1939-2 C. B. 21 (taxpayer allowed to deduct amounts paid to his former wife to enable her to pay interest on a mortgage covering property transferred to the wife in a divorce settlement); *F. C. Nicodemus, Jr.*, 26 B. T. A. 125 (1932), Acq. XIV-2 C. B. 16 (husband taxpayer entitled to deduct all mortgage interest and real estate taxes even though the real estate was jointly owned with his wife who was therefore jointly liable); and I. T. 3304, 1939-2 C. B. 158 (husband who paid to repair hurricane damage to jointly held property entitled to claim the entire loss).

## CONCLUSION.

There is a conflict of decisions which requires resolution by this Court. The petition should accordingly be granted.

Respectfully submitted,

CONVERSE MURDOCH,
350 Delaware Trust Building,
Wilmington 1, Delaware,
*Counsel for Petitioners.*

## APPENDIX.

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IN THE

UNITED STATES COURT OF CLAIMS

No. 516-58

(Decided March 1, 1961)

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THOMAS CRAWLEY DAVIS AND GRACE ETHEL DAVIS

*v.*

THE UNITED STATES

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Converse Murdoch for plaintiffs.

*Peter J. Donahue*, with whom was *Assistant Attorney General Charles K. Rice*, for defendant. *James P. Garland* and *Lyle M. Turner* were on the brief.

### Opinion.

LARAMORE, *Judge*, delivered the opinion of the court:

Plaintiff[1] sues to recover an alleged overpayment of taxes for the year 1955. The Commissioner of Internal Revenue proposed to assess a tax deficiency in the sum of $6,318.66 on the basis of disallowance of the deduction of $5,000 for legal fees, and on the basis of including in plaintiff's gross income a net long-term capital gain of $3,737.31, representing the difference between the tax basis to plaintiff of 500 shares of du Pont stock transferred to Alice M.

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1. Grace Ethel Davis, co-plaintiff, is the present wife of Thomas Crawley Davis. A joint tax return was filed for the year 1955. For this reason she joins as plaintiff in this proceeding. Hereinafter, all references to taxpayer will refer to Thomas Crawley Davis alone.

Davis, his former wife, during 1955 and the fair market value of such shares as of the date of transfer to her. The cost basis of the 500 shares of stock transferred on March 21, 1955, was $74,775.37. This stock had a fair market value on that date of $82,250, or an increase in value over the cost basis of $7,474.63, one-half of which gain, or $3,-737.31, was taken into account in the proposed deficiency assessment.

On February 14, 1958, plaintiff paid to the District Director the amount of $6,961.95, representing the asserted deficiency for 1955 in the amount of $6,318.66, plus interest of $643.29.

On April 8, 1958, plaintiffs filed their claim for refund of Federal income taxes paid for 1955 in the sum of $13,642.29. This claim was based on the failure to include all of the $12,506 of legal fees paid by Mr. Davis to a Mr. Young and a Mr. Morford on January 27, 1955, for legal services. Plaintiffs asserted in their claim that $2,500 was on that date paid to each attorney, or a total of $5,000, for legal services in connection with various Federal tax matters arising out of negotiations and execution of a separation and property settlement agreement between Mr. Davis and Alice M. Davis, his former wife. Plaintiffs further asserted that additional sums as legal fees, $5,006 to Mr. Young and $2,500 to Mr. Morford, were paid on January 27, 1955, for services in connection with the negotiations and execution of the same settlement agreement primarily incurred in connection with the protection of Mr. Davis' position as a stockholder, officer, and director of du Pont. This claim further asserted that the inclusion in income of the net long-term capital gain of $3,737.31 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955, was erroneous, because such transfer was pursuant to the same separation and property division agreement and did not result in any income or gain to the taxpayer.

By registered letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified

plaintiffs of the disallowance in full of their claim for refund for the year 1955. This suit results.

Plaintiff contends in this suit that he is entitled to a deduction for two types of legal fees paid by him: First, legal fees paid for tax advice, and second, legal fees incurred in connection with the matter principally involving the protection of plaintiff's position as a stockholder, director, and officer of the du Pont Company. His contention with respect to the taxable gain on the stock transferred will be discussed later.

Plaintiff points to section 212(3) of the Internal Revenue Code of 1954, which was applicable for the calendar year 1955, in support of his contention that legal fees paid for tax advice in connection with the negotiations of the property division and separation agreement are deductible.

Section 212(3) provides:

Sec. 212. Expenses for Production of Income.

> In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
>
> * * *
>
> (3) in connection with the determination, collection, or refund of any tax.

Plaintiff then points to the Treasury Regulations under the above-quoted statutory provision as supporting his contention.

Treasury Regulation § 1.212-1 reads as follows:

> § 1.212-1. Nontrade or nonbusiness expenses.—
>
> (1) Expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be Federal, State, or municipal, and whether the tax be income, estate, gift, property, or any other tax, are deductible. Thus, expenses paid or incurred by a taxpayer for tax

> counsel or expenses paid or incurred in connection with the preparation of his tax returns or in connection with any proceedings involved in determining the extent of tax liability or in contesting his tax liability are deductible.

Section 212(3) plaintiff says applies for the reason that the evidence shows that both Thomas Crawley Davis and his former wife were constantly aware of Federal income and gift tax problems which would vitally affect both parties in the negotiation. Further, that a new income tax code had just previously been enacted which involved extensive revisions of the prior internal revenue laws, and that tax advice was sought from attorneys for both parties. Consequently, plaintiff contends that he is entitled to deduct the fees paid as services for "* * * tax counsel or expenses paid or incurred in connection with the preparation of * * * tax returns * * *."

We have no doubt that Congress in enacting section 212, *supra*, meant to grant a deduction for legal fees in connection with a determination, collection, or refund of any tax. The question then is whether the fees paid by plaintiff come within the purview of the Act. In the light of the Treasury Regulations promulgated thereunder, we think the question can only be answered in the affirmative. The Regulation, section 1.212-1, quoted above, specifically provides that expenses paid or incurred for tax counsel "* * * in connection with any proceedings involved in determining the extent of tax liability * * * are deductible." Therefore, it seems clear that the statute and regulations are broad enough to cover the deduction asked for.

The facts here show that in negotiating the separation and property settlement agreement, both Mr. Young and Mr. Morford considered the Federal income and gift tax consequences flowing from the various phases of the proposals made during the course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client, and this same concentration for

the interests of his own client was ~~practiced~~ by each attorney in negotiating the overall aspects of the property settlement agreement.

Further, the facts show that the bills for attorneys' fees were separated into two categories—one for services regarding the separation agreement, and the other for services in regard to tax matters. In this connection there is no evidence indicating that such allocation was done in bad faith, and the cases are legion holding that absent such evidence, such allocation should be accepted. *Maine Steel, Inc. v. United States*, 174 F. Supp. 702, 716 (1959); *Anita M. Baldwin*, 10 B. T. A. 1198 (1928). Cf. *Joseph Frank*, 22 T. C. 945 (1954), aff'd per cur. 226 F. 2d 600, (1955); *Bryant Heater Co. v. Commissioner*, 231 F. 2d 938, (1956).

In view of the foregoing, it seems obvious that the fees paid by plaintiff for consultation and advice in tax matters arising in connection with the settlement agreement are properly deductible from gross income.

This is not to say, however, that the fees paid to his former wife's attorney, Mr. Morford, are also deductible. In spite of the fact that Mr. Davis was legally liable for his wife's attorney's fees, the evidence conclusively shows that Mr. Morford worked exclusively for his client, Mrs. Davis, and considered the problems from the standpoint of his client alone. Certainly then it cannot be said that Mr. Morford's advice was directed to plaintiff's tax problems, and in order to qualify for a deduction, we think the attorneys' fees must be directly and only connected with the taxpayer's estate. Consequently, we hold that only the attorney's fees paid by plaintiff to his personal attorney, Mr. Young, for tax advice, are properly deductible from his 1955 gross income.

Next we turn to the question of whether the taxpayer is entitled to deduct the amount paid Messrs. Young and Morford, representing charges for legal services in connection with the negotiation of a property division and separation agreement.

In this connection plaintiff contends that the legal fees were paid in connection with the preservation of his position as a stockholder, director, and officer of the du Pont Company and that said fees are deductible under the provisions of section 212(1)(2) of the Internal Revenue Code of 1954, *supra*.

At the outset of the discussion respecting this issue, we point out that the taxpayer is not entitled to a deduction for personal, living or family expenses under section 262 of the Internal Revenue Code of 1954, *supra*, and Treasury Regulation § 1.262-1(b)(7).

Section 262 of the Internal Revenue Code of 1954, *supra*, reads as follows:

> PERSONAL, LIVING, AND FAMILY EXPENSES
>
> Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living or family expenses.

Treasury Regulation section 1.262-1(b)(7) provides:

> Personal, Living, and Family Expenses.—(a) *In general.* in computing taxable income, no deduction shall be allowed, except as otherwise expressly provided in chapter 1 of the Internal Revenue Code of 1954, for personal, living and family expenses.
>
> (b) Examples of personal, living, and family expenses. Personal, living, and family expenses are illustrated in the following examples:
>
> * * *
>
> (7) Generally, attorney's fees and other costs paid in connection with a divorce, separation, or decree for support are not deductible by either husband or the wife. * * *

Therefore, in order to bring himself under the section permitting the deduction, plaintiff must show that the legal expenses were incurred in matters directly related to his

business or the management, conservation or maintenance of property held for the production of income. See *Port v. United States*, 143 Ct. Cl. 334.

Plaintiff cites the cases of *McMurtry v. United States*, 132 Ct. Cl. 418 (1955); *Baer v. Commissioner*, 196 F. 2d 646 (1952); *Bowers v. Commissioner*, 243 F. 2d 904 (1957); and *Fisher v. United States*, 157 F. Supp. 364 (1957).

Defendant in opposition cites the U. S. Supreme Court decision in the case of *Lykes v. United States*, 343 U. S. 118 (1951), wherein the Supreme Court reviewed the legislative history of section 23(a)(2) of the 1939 Code, the predecessor to section 212 of the 1954 Code, which showed that Congress intended to allow deduction for income-producing activities of a commercial nature only and did not intend to allow the deduction of any expense designed to aid taxpayer to retain their property. The Supreme Court in *Lykes* stated at page 125:

> Legal expenses do not become deductible merely because they are paid for services which relieve a taxpayer of liability. That argument would carry us too far. It would mean that the expenses of defending almost any claim would be deductible by a taxpayer on the ground that such defense was made to help him keep clear of liens whatever income-producing property he might have.

Admittedly, some courts have departed from the philosophy of the *Lykes* decision. *Baer v. Commissioner, supra; McMurtry v. United States, supra; Bowers v. Commissioner, supra; Owens v. Commissioner*, 273 F. 2d 251 (1959); *Fisher v. United States, supra;* and *Patrick v. United States*, 186 F. Supp. 48 (1960). However, many courts have not followed the departure or have distinguished the case on factual grounds. *Lewis v. Commissioner*, 253 F. 2d 821 (1958); *Tressler v. Commissioner*, 228 F. 2d 356 (1955); *Howard v. Commissioner*, 202 F. 2d 28 (1953); *Richardson v. Commissioner*, 234 F. 2d 248 (1956); *Smith's*

*Estate v. Commissioner*, 208 F. 2d 349 (1953); *Donnelly v. Commissioner*, 16 T. C. 1196 (1951); *Estate of Walsh v. Commissioner*, 28 T. C. 1274 (1957); *Douglas v. Commissioner*, 33 T. C. 349 (1959).

Of course, the defendant contends the rule in the *Lykes* case as followed by the court in the case of *Lewis v. Commissioner, supra,* is correct. On the other hand, plaintiff is just as positive that the *McMurtry, Baer, etc.,* cases provide the correct rule.

However, we believe that it is not necessary here to choose which decision is correct in the premises. We believe the cases cited by plaintiff are factually distinguishable from the facts in the case at bar.

The *McMurtry* decision, *supra,* related to a situation wherein the plaintiff's position to some extent depended on the amount of his stockholdings in the company.

In the *Baer* case, *supra,* the taxpayer owned a controlling interest in a closely held corporation and to have acceded to his wife's demands would have resulted in not only loss of control of the company and loss of dividends, but no doubt would have resulted in loss of his salary as well, if other and adverse parties gained control.

In *Bowers v. Commissioner, supra,* and *Patrick v. United States, supra,* as well as *Fisher v. United States, supra,* practically the same situation as in *Baer, supra,* existed. It was necessary for *Bowers* to retain the stock in order to maintain his control, management and income.

In the present case by contrast, almost all the legal expenses were incurred by reason of the marital rift between Mr. and Mrs. Davis. As a consequence thereof, his attorney's fees were practically all incurred in an effort to hold to a minimum the amount necessary to effect a property settlement. It naturally follows that the attorney's fees paid for Mrs. Davis' attorney were to gain a maximum amount in the property settlement agreement. Furthermore, we believe from the evidence that in any event plaintiff has failed to prove that retention of the stock was

necessary to maintain him as an officer and director of du Pont. As a matter of fact, at the time of Davis' election to the Board, his stockholdings were substantially less than those of any other person nominated by the management for election to the Board. Furthermore, during Mr. Davis' service as a director, every person nominated by the management of du Pont was elected by the stockholders as a director.

Therefore, we think the facts of this case more nearly come under the rule laid down by the court in the cases of *Lewis v. Commissioner, supra; Tressler v. Commissioner, supra; Howard v. Commissioner, supra; Richardson v. Commissioner, supra; Smith's Estate v. Commissioner, supra; Donnelly v. Commissioner, supra; Estate of Walsh v. Commissioner, supra; Douglas v. Commissioner, supra.*

The above cases all stand for the proposition that attorneys' fees generally seek to conserve estates but are not necessarily the basis for a deduction under the Internal Revenue Code. Thus we believe the rule of the *Lewis* case, *supra,* is the correct one in these premises; *i.e.,* following the Supreme Court's decision in *Lykes v. United States, supra,* the Court held that the legal expenses were not deductible. The above reasoning was followed by this court in the case of *Port v. United States, supra.*

Thus we hold that the attorneys' fees paid to both lawyers constituted personal expenses which are nondeductible under section 262 of the 1954 Code, *supra.*

The next and final contention of the taxpayer is that the taxpayer did not realize taxable gain by virtue of the stock transfer to his former wife pursuant to the property settlement agreement, and consequently the inclusion in income of the net long-term capital gain was erroneous.

The facts respecting the above situation are these: Pursuant to the separation agreement the taxpayer, Davis, transferred 500 shares of du Pont stock to his former wife, Alice M. Davis, in 1954. The taxpayer's cost basis of the stock was $74,775.37 and the fair market value at the time

of transfer was $82,250. The difference was taxed as capital gain under section 1001 of the Internal Revenue Code of 1954, 26 U. S. C. § 1001 (1958 Ed.) which provides:

DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

Plaintiff contends that the transfer of the stock was not in satisfaction of Alice M. Davis' right to support and maintenance, but was a part of a division of property. Plaintiff argues that Mrs. Davis' rights to support and maintenance were satisfied by the payment of $550 per month and the payment of dividends on a maximum of 1,000 shares of du Pont stock. This is so, plaintiff says, because the division of property was contained in one paragraph of the separation agreement, whereas the payments in lieu of alimony were in another paragraph.

It is the defendant's contention that under the rule laid down in the case of *Commissioner v. Mesta*, 123 F. 2d 986 (1941), cert. denied 316 U. S. 695 (1942), and *Commissioner v. Halliwell*, 131 F. 2d 642 (1942), cert. denied 319 U. S. 741, the increment in value was clearly taxable gain.

Plaintiff then argues the incorrectness of the *Mesta* decision, *supra*, and concludes with the statement in his brief that "plaintiffs are not prepared to concede the correctness of the *Mesta* decision, but believe that since the rule of that case is not here applicable it is not necessary to further con-

sider the *Mesta* case." Plaintiff further contends that the *Mesta* decision is not applicable because that case involved a transfer of property in connection with a division of property and not a transfer in satisfaction of the husband's (plaintiff Davis) obligation to support. To support this contention plaintiff cites the case of *Commissioner v. Marshman*, 279 F. 2d 27 (1960), cert. denied — U. S. —.

Thus the situation is this: The Court of Appeals in the Third Circuit in a case involving an almost identical proposition, in 1941 found that there was a taxable capital gain. The Supreme Court denied certiorari. In 1942 the Court of Appeals, Second Circuit, in a substantially same situation reversed the Tax Court and found against the taxpayer. *Commissioner v. Halliwell, supra.* The Supreme Court denied certiorari. The ruling in the *Mesta* case, *supra*, was cited with approval and followed by the court in *Halliwell*. Then in 1960, after the Tax Court had followed the 1941 and 1942 decisions, the Court of Appeals for the Sixth Circuit in the *Marshman* case, *supra*, reversed the Tax Court and specifically rejected the rule of the two cases in the Second and Third Circuit. The *Marshman* situation also is almost identical with the facts in the instant case. On December 12, 1960, the Supreme Court denied certiorari in the *Marshman* case. The result is that we are faced with two precedents pointing in opposite directions and an attempt to distinguish the two is impossible.

Since there is no clear ground for distinguishment between the rule of the *Mesta-Halliwell* cases and the *Marshman* case, it behooves us to decide which rule is the correct one in the premises. While admittedly it is a troublesome question, we are of the opinion that the facts of the instant case more nearly come under the reasoning and the rule of the *Marshman* case. We say this because the statute, section 1001(b), expressly states that the amount realized from the sale or other disposition of property shall be the sum of any money *received* plus the fair market value of the property *received*. We think as did the court in *Marshman*,

*supra*, that the measurement of gain cannot be the fair market value of the property transferred. We also believe, as did the court in *Marshman*, that the measure of the value of the wife's right to maintenance and support was dependent upon so many uncertain factors that neither the taxpayer nor a revenue officer could do more than guess at it.

Furthermore, to say that the fair market value of the property received is the same as the fair market value of the property given up, is the use of a formula different from the well-established formula for determining fair market value. Fair market value is the price at which property would change hands between a willing seller and a willing buyer, neither being under any compulsion to buy or sell. Again we agree with the court in the *Marshman* case that a transaction between a husband and a wife made under the emotion, tension and practical necessities involved in a divorce proceeding does not comply with this rule.

Under the evidence of this case, like *Marshman*, many demands were made, many concessions were made, and under these circumstances values are lost sight of. This is especially true under the circumstances of this case wherein the husband even became ill because of the tensions resulting from the marital troubles. So it is reasonable to say that in some measure the husband was willing to pay at least some amount in order to have the marriage terminated. In these circumstances, the value of what was given up is no criterion of the fair market value of the "property" received.

For the above reasons, we cannot agree with the ruling in the *Mesta* case that the fair market value of the release by a wife of her alimony and dower rights against her husband and his estate is properly determined by ascertaining and giving to it the fair market value of the property which she received from her husband.

If the "property" received by Davis had no fair market value, or if none has been shown, it may be economic gain but it is not taxable gain by reason of the express provision

of section 1001(b). *Champlin v. Commissioner*, 71 F. 2d 23, 29.

Therefore, we believe that T. C. Davis did not realize taxable gain by virtue of the 1955 transfer of stock pursuant to the property settlement agreement. Consequently, plaintiff is entitled to recover the amount paid pursuant to the inclusion of capital gain in his 1955 tax, in addition to the amount paid by reason of the inclusion of attorney's fees paid his attorney for tax advice.

The exact amount of recovery will be determined pursuant to Rule 38(c).

It is so ordered.

Durfee, *Judge;* Madden, *Judge;* Whitaker, *Judge;* and Jones, *Chief Judge,* concur.

## Findings of Fact

The court, having considered the evidence, the report of Trial Commissioner Reald A. Hogenson, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiffs are citizens of the United States and residents of the State of Delaware. At the end of the calendar year 1955, they were husband and wife.

2. Plaintiff, Thomas Crawley Davis, had been previously married to Alice M. Davis, such marriage having existed from March 1, 1941, to January 5, 1955. On the latter date, Alice M. Davis, hereinafter referred to as Mrs. Davis, was granted an absolute and final decree of divorce from Mr. Davis upon the stated ground of "extreme cruelty, mental in nature," by the Second Judicial District Court of the State of Nevada. The separation and property settlement agreement of the parties, hereinafter mentioned in these findings, was approved by the Nevada court and incorporated by reference in its decree which, by its terms, ordered and directed the parties to comply with and to exe-

cute the terms and conditions of the agreement. Both parties were represented at the proceedings by Nevada attorneys who had not participated in any way in the preparation and execution of the agreement. Mrs. Davis appeared in person at the trial, but Mr. Davis did not personally participate.

3. Since 1934, Mr. Davis has been associated with E. I. du Pont de Nemours & Company, hereinafter referred to as du Pont or the company, in various capacities as an employee, officer, director and stockholder. His employment record with du Pont from November 16, 1934, to the date of the trial of this case on April 30, 1959, was as follows:

11-16-34 to 11-30-41 Manager, Tax Division, Treasurer's Department
12-1-41 to 8-26-44 Assistant Comptroller, Treasurer's Department
8-27-44 to 5-19-46 Assistant Treasurer, Treasurer's Department
5-20-46 to 1-18-48 First Assistant Treasurer, Treasurer's Department
1-19-48 to 12-20-53 Treasurer of the Company
12-21-53 to 4-30-59 Member, Board of Directors, Member, Executive Committee, Vice President
11-1-54 to 4-30-59 Member, Finance Committee

4. From 1902 to the present time, du Pont has had a policy and practice of granting bonuses to its officers and employees. Prior to 1943, such bonuses were awarded in the form of du Pont stock. Due to the impact of the Federal withholding tax on incomes, such bonus awards were paid entirely in cash from 1943 to 1946. Beginning in 1947, such bonuses were paid partly in du Pont stock and partly in cash.

One of the primary purposes of the company in awarding bonuses in the form of stock was to tie the bonus awardees to the company as stockholders and thus intensify

their interest in the company's business. It was generally known that the company's top officials expected bonus awardees to retain their du Pont stock, the recognized exceptions being in cases of necessity to sell bonus stock to pay income taxes or to purchase a suitable home.

5. Prior to the annual meeting of the du Pont stockholders, the secretary of the company each year prepares an analysis of the holdings and dispositions of stock by executives of the company. The president, vice presidents, and directors are and were expected to explain any substantial disposition of their stock.

Proxy statements issued by du Pont to its stockholders prior to each annual meeting show the holdings of du Pont stock by those persons nominated by the du Pont management for election or reelection by the stockholders to the company's board of directors.

6. During November 1953, Mr. Davis was advised by the president and by the chairman of the board of du Pont that he was being considered for election as a director, vice president and member of the executive committee of the company. At that time Mr. Davis had 2,842 shares of du Pont common stock registered in his name.

Effective December 21, 1953, Mr. Davis was elected by the board of directors as a director, vice president, and member of the executive committee of du Pont. As a director, Mr. Davis was subject to reelection by the stockholders at the succeeding annual meetings in April of each year. Mr. Davis has continued to hold such offices up to the present time. Since November 1, 1954, Mr. Davis has also been a member of the finance committee of the company.

7. The changes in the du Pont stock holdings of Mr. Davis from February 28, 1953, through 1958, were as follows:

| | *Shares in* | *Shares out* | *Shares remaining* |
|---|---|---|---|
| Feb. 28, 1953 ........................ | — | — | 2,302 |
| Mar. 5, 1953 ........................ | 421 | — | 2,723 |
| July 27, 1953 ........................ | 319 | — | 3,042 |
| Sept. 1, 1953 ........................ | — | 200 | 2,842 |
| Mar. 4, 1954 ........................ | 574 | — | 3,416 |
| Mar. 18, 1954 ........................ | — | 100 | 3,316 |
| Apr. 27, 1954 ........................ | — | 100 | 3,216 |
| Oct. 7, 1954 ........................ | — | 100 | 3,112 |
| Nov. 22, 1954 ........................ | — | 100 | 3,016 |
| Mar. 3, 1955 ........................ | 65 | — | 3,081 |
| Mar. 21, 1955 ........................ | — | 500 | 2,581 |
| Jan. 30, 1956 ........................ | — | 7 | 2,574 |
| Feb. 29, 1956 ........................ | 44 | — | 2,618 |
| Mar. 21, 1956 ........................ | — | 100 | 2,518 |
| Mar. 27, 1956 ........................ | — | 500 | 2,018 |
| Feb. 27, 1957 ........................ | 286 | — | 2,304 |
| Oct. 15, 1957 ........................ | — | 10 | 2,294 |
| Dec. 16, 1957 ........................ | — | 6 | 2,288 |
| July 18, 1958 ........................ | — | 16 | 2,272 |

The disposition of 200 shares on September 1, 1953, 500 shares on March 21, 1955, and 500 shares on March 27, 1956, were to Mrs. Davis, as hereinafter related in these findings. The evidence indicates that the other dispositions were in the main for the purpose of paying Federal income taxes, and meeting the cash payments required by the separation and property settlement agreement.

All of Mr. Davis' du Pont stock holdings were acquired by him through bonus awards by the company.

8. The income of Mr. Davis for the years 1949 through 1953 was as follows:

| | *1949* | *1950* | *1951* | *1952* | *1953* |
|---|---|---|---|---|---|
| Salary and bonus from du Pont | $86,117.43 | $114,405.08 | $147,767.14 | $169,612.22 | $204,998.66 |
| Dividends on du Pont stock .. | 3,931.30 | 7,653.65 | 6,360.70 | 7,405.65 | 9,082.75 |
| Other income, or capital gains or loss ......... | (856.22) | 3,470.51 | 695.28 | —— | —— |
| Totals ... | 89,192.51 | 125,529.24 | 154,823.12 | 177,017.87 | 214,081.41 |

**9. For the calendar years 1954 and 1955, Mr. Davis' adjusted gross income amounted to the respective sums of $264,984.69 and $317,865.16, of which the following represented payments from du Pont:**

| | *1954* | *1955* |
|---|---|---|
| Salary | $87,437.48 | $90,600.00 |
| Dividends treated as salary | 4,090.00 | 3,592.75 |
| | 91,527.48 | 94,192.75 |
| Bonus | 152,705.97 | 208,016.27 |
| Director's fees | 550.00 | 500.00 |
| Dividends on du Pont stock | 13,239.02 | 15,036.00 |
| Totals | 258,022.47 | 317,745.02 |

**10. Mr. Davis' net worth statement as of July 1, 1954, was as follows:**

| | | |
|---|---|---|
| Cash in bank—Wilmington Trust Co. | | $ 28,073 |
| Shares of du Pont common stock: | | |
| Registered in his name | 3,216 shares | |
| Deduct: held by company as unearned bonus | 802 shares | |
| Remainder (including 100 shares pledged to Farmers Bank) | 2,414 shares @ $134.25 | 324,079 |
| Insurance policies having cash surrender value: | | |
| Travelers Insurance Co. $10M policy | | 5,000 |
| U. S. Veterans Administration $10M policy | | 5,000 |
| Great Western Life Assurance Co. $50M policy | | 21,717 |
| Pan American Life Assurance Co. $50M policy | | 17,493 |
| Dominion Life Assurance Co. $50M policy | | 16,407 |
| Home on Kennett Pike | | 76,000 |
| Home furnishings | | 15,000 |
| Automobiles (3) | | 3,000 |
| | | 511,769 |
| 1954 Federal income tax unpaid | $82,079 | |
| Mortgage on home | 18,000 | |
| Borrowing from Farmers Bank | 63,761 | |
| | | $163,840 |
| Net Worth—July 1, 1954 | | 347,929 |

As of July 1, 1954, delivery of 802 of the 3,216 shares of du Pont stock registered in Mr. Davis' name had been deferred to later years. Under the du Pont bonus plan, the 802 shares were subject to forfeiture in the event that prior to actual delivery to him, Mr. Davis' services with du Pont were terminated other than through death or retirement pursuant to the company's program.

All of the property of the parties involved in the property settlement negotiations was owned by Mr. Davis subject only to the marital rights of Mrs. Davis under the laws of the State of Delaware.

11. For a period of many years, Mr. and Mrs. Davis had had many disagreements of a personal nature, which finally led Mrs. Davis to seek a separation in June 1954. About the middle of the year 1953, Mrs. Davis requested Mr. Davis to transfer one-half of his property into her name, including 1,500 shares of du Pont stock, but she did not then request a divorce or separation. Mr. Davis rejected these property demands, but offered to make future transfers of du Pont stock to Mrs. Davis as long as his stock holdings did not fall below 3,000 shares. Mr. Davis advised Mrs. Davis that otherwise his position with du Pont would be seriously jeopardized by stock transfers. On September 1, 1953, Mr. Davis transferred 200 shares of du Pont stock to Mrs. Davis to allay her demands. By December 1953, their relations had become so strained that they could not converse without quarrelling and there was great unhappiness in their home. Mrs. Davis' demands for a property division became more insistent, and in February 1954 she refused to sign a joint Federal income tax return until her request for property had been met.

In the week preceding June 15, 1954, Mrs. Davis consulted an attorney, Mr. James R. Morford, concerning her marital troubles and about obtaining a property settlement. Mrs. Davis then advised Mr. Davis that she had retained Mr. Morford, and requested Mr. Davis to retain an attorney

to negotitate [sic] a separation agreement. Mrs. Davis' primary purpose in seeking a separation was to terminate a marital relationship which, for personal reasons, had not been successful. Mr. Davis at first declined, and refused to discuss a separation agreement or property settlement, but thereafter in the summer of 1954 retained an attorney, Mr. H. Albert Young to represent him. At Mr. Davis' request, Mr. Young requested Mr. Morford to make an effort to accomplish a reconciliation of the parties, but Mrs. Davis rejected the proposal after a conference with her attorney.

12. Mrs. Davis' initial proposal for a property settlement and separation agreement was made through the respective attorneys to Mr. Davis on July 13, 1954. Mrs. Davis proposed that she would move from the home of the parties, receive one-half of the appraised value of the home and furnishings, take one automobile, receive 1,500 shares of du Pont stock, a sufficient annual payment to pay the interest on an insurance loan, have custody of the minor child, and receive $400 per month for support of the child. As a first alternative, Mrs. Davis proposed that in lieu of the 1,500 shares of du Pont stock she would accept $1,000 per month for life with the understanding that she would support the child. As a second alternative, Mrs. Davis proposed that in lieu of immediate delivery of the du Pont stock, she would accept the $1,000 per month payment until Mr. Davis' retirement from du Pont, and then in lieu of any subsequent support payments, transfer of 1,500 shares of du Pont stock upon his retirement.

On August 24, 1954, Mr. Davis made a counterproposal through the respective attorneys to award one of the automobiles to Mrs. Davis, pay her $24,000 for one-half of the net value of the home and furnishings, pay off the $18,587.99 loan on a $50,000 insurance policy and award Mrs. Davis this policy, on condition she pay future premiums, award Mrs. Davis two unencumbered insurance policies aggregating $20,000 on the condition she assume future premium

payments, to create an irrevocable trust for the minor child and pay $700 per quarter for 40 quarters, or $28,000 in 10 years, into a trust estate to be disbursed by the trustee for the support and education of the minor child, and to pay $18,000 per annum for ten years in quarterly installments to Mrs. Davis for her support and maintenance, with no stock to be transferred. Mr. Davis later amended this proposal by increasing the proposed cash payment for the one-half value of the house and furnishings from $24,000 to $30,000.

These proposals and counterproposals having been successively rejected, a conference was held between Mr. and Mrs. Davis and their respective attorneys, and the parties then accomplished and executed the formal property settlement and separation agreement, dated November 4, 1954, included in the Nevada decree of divorce, and hereinafter related in these findings.

13. The separation and property settlement agreement recited that various disputes and differences had arisen between the husband and wife, and that they had permanently separated. It was further recited that "the parties hereto intend by this agreement to settle their respective rights and obligations against and to one another by (1) making a division of their property; (2) providing in lieu of alimony in the event of a decree of divorce for the support and maintenance of the wife; (3) making an arrangement and provision for the support and maintenance of Stephen; and (4) defining the rights of custody, maintenance, support and education of their minor child."

The agreement then provided a "division in settlement of their property." Mr. Davis was awarded the home property and all furnishings and personal property thereon on condition that he pay Mrs. Davis $30,000 in cash and that Mrs. Davis have a certain automobile and certain listed items of furniture and furnishings. Mr. Davis agreed to make future transfers of a total of 1,000 shares of du Pont stock to Mrs. Davis, 500 shares on April 1, 1955, and 500

shares on April 1, 1956. Mr. Davis also agreed to deliver to his wife as owner-beneficiary, not later than February 28, 1955, the following life insurance policies, free of all liens and encumbrances: the fully paid-up Dominion Life Assurance Company policy for $50,000; and the two New England Mutual Life Assurance Company policies, each for $10,000 and each having premiums fully paid to September 20, 1955. Mrs. Davis agreed to relinquish all rights to any other insurance policy.

Mr. Davis agreed to pay to Mrs. Davis "for her maintenance and support" the sum of $2,500 on December 15, 1954, and $550 per month payable on the first day of each month for the ten-year period from November 1, 1954, to October 1, 1964. Mrs. Davis agreed that she would accept these payments "in lieu of all claims against the husband for maintenance and support, past, present, and future."

Mr. Davis also agreed to pay to Mrs. Davis "for her maintenance and support" a sum of money equivalent to the per-share dividend thereafter declared on du Pont stock, multiplied by the number of shares which, by the agreement of the parties, was to be transferred to Mrs. Davis in the future, but which number of shares remained untransferred at the effective date of the dividend payment.

Mrs. Davis agreed to accept "the division of property herein provided in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy), which she ever had, now has, or might ever have against the husband by reason of their relationship as husband and wife or otherwise."

The agreement recited that Mrs. Davis would have the custody of the minor child of the parties, subject to reasonable visitation by Mr. Davis, and also provided that Mr. Davis would create an irrevocable trust, by executing an instrument in the form of that attached to the agreement, to

provide "for the support, maintenance and education" of the minor child, and pay $700 per quarter-year commencing January 1, 1955, for 40 quarters, or ten years, into the trust estate, to be expended by the trustee for the education and use and benefit of the minor child. The agreement also required Mr. Davis to provide a $10,000 life insurance policy for the protection of the trust estate.

Both parties agreed to execute instruments necessary to carry the agreement into effect, and Mrs. Davis agreed to sign a joint Federal income tax return for 1954.

The agreement provided for a mutual release of all other debts, claims, and obligations, and also that Mrs. Davis upon the performance of Mr. Davis' undertakings waived all claims which she might otherwise have to any of the property of Mr. Davis and to any claim for support or maintenance of herself or the minor child.

The agreement further provided that in the event a decree of divorce should be granted, dissolving the marriage, the provisions of the agreement might, but need not be, incorporated into such decree, subject to the approval of the court granting such divorce.

14. Throughout the negotiations for the separation and property settlement agreement, and in property discussions prior thereto, Mr. Davis reasonably and honestly believed that immediate transfer to Mrs. Davis of 1,500 shares of du Pont stock would seriously jeopardize his chances of election and reelection as a member of the du Pont board of directors, as a member of its executive committee and as a vice president of the company. He consistently related this belief to Mrs. Davis and to their respective attorneys, and resisted transfer of any stock until and in conformity with the settlement and separation agreement of November 4, 1954. Mr. Davis believed that his associates in the top management of du Pont would understand and accept the necessity of transfer of stock in connection with the property settlement and separation agreement, but thought that

it would not be acceptable to the stockholders in their election of the directors at their annual meetings.

At the time of his election to the board of directors of du Pont, Mr. Davis' stock holdings in the company were substantially less than those of any other person nominated by the management for election to the board. In subsequent years, only two directors, both of whom were recognized scientists, held fewer du Pont shares than Mr. Davis. Mr. Davis continued to be renominated by the management and reelected by the stockholders as a member of the board despite the transfers of his shares, as shown in finding 7. During Mr. Davis' service as a director, every person nominated by the management of du Pont was elected by the stockholders as a director.

15. Neither Mr. Young as attorney for Mr. Davis, nor Mr. Morford as attorney for Mrs. Davis, acted for either party in connection with the suit for divorce in Nevada, except that Mr. Young by telephone engaged a Nevada law firm which independently handled the proceedings.

16. The matter of obtaining a decree of divorce or decree of legal separation was not proposed by either Mr. Davis or Mrs. Davis until November 1954. The marital difficulties had caused Mr. Davis such great discomfort and emotional upset that it had been necessary for him to be hospitalized. Mr. Davis concluded and advised Mrs. Davis that from his standpoint a divorce should be obtained. Thereafter discussions were carried on between Mrs. Davis, Mr. Morford, and Mr. Young about divorce proceedings, and the Nevada divorce suit was thereafter prosecuted by Nevada attorneys.

17. In negotiating the separation and property settlement agreement, both Mr. Young and Mr. Morford considered the federal income and gift tax consequences flowing from the various phases of the proposals made during the

course of negotiations. Each attorney, however, considered such problems from the standpoint of his own client, and this same concentration for the interests of his own client was practiced by each attorney in negotiating the overall aspects of the property settlement agreement.

18. Both Mr. Young and Mr. Morford had had many years of experience as successful practicing lawyers in the State of Delaware. In the negotiations involved in this case, they advised Mr. Davis that it was the practice in conformity with Delaware law that the husband pay the attorneys' fees of both parties in connection with negotiations for a separation and property settlement agreement. As a result of this advice, Mr. Davis understood that he had to pay the fees of Mrs. Davis' attorney, and agreed to do so.

19. The separation and property settlement agreement contained no provisions concerning payment of attorneys' fees. However, in accordance with the oral understanding, Mr. Davis paid to his own attorney, Mr. Young, total fees in the sum of $12,506, and total fees to Mrs. Davis' attorney, Mr. Morford, in the sum of $10,000.

On November 17, 1954, Mr. Young provided Mr. Davis with two separate bills, one for $7,506, for his services "Re: Separation Agreement and Property Division between T. C. Davis and Alice M. Davis," and the other for $5,000 for his services "Re: Tax matters in the case of Davis v. Davis." Each of these bills showed that Mr. Davis had made a payment of $2,500 on each of them on November 16, 1954, leaving respective balances of $5,006 and $2,500.

On December 16, 1954, Mrs. [sic] Morford provided Mr. Davis with two separate bills, one for $5,000 "To professional services in the matter of division of property and the preparation of separation agreement between T. Crawley Davis and Alice M. Davis," and the other for $5,000 "To professional services rendered in connection with tax

matters involved in the matter of Alice M. Davis versus T. Crawley Davis." Each of these bills showed that Mr. Davis had made a payment of $2,500 on each of them on November 14, 1954, leaving a balance on each bill of $2,500.

On January 27, 1955, Mr. Davis paid his attorney, Mr. Young, the sums of $5,006 and $2,500, being the balances on the two bills submitted to him by Mr. Young.

On January 27, 1955, Mr. Davis made two payments to Mrs. Davis' attorney, Mr. Morford, of $2,500 each, being the respective balances on the two bills submitted to him by Mr. Morford.

Mr. Morford testified in this case that he split his overall fee into two categories at the request of Mr. Davis, and that he could not possibly segregate his fee in such manner and justify the amount of one bill as against the other. He later testified that tax problems underlaid the whole relationship of the parties and that his general opinion was that the segregation of the total fee, as it was done at the request of Mr. Davis, appeared to him to be entirely reasonable. In his appearance as a witness in this case, Mr. Young's testimony was vague and general as to the reasonableness and propriety of the division of his overall fee into the two categories, and he did not state whether the segregation was made by him independently or at the suggestion of Mr. Davis.

20. There is no testimony or evidence in this case from which it can be determined the extent to which the attorneys' fees paid by Mr. Davis either to Mr. Young or to Mr. Morford were reasonably allocable to the effort of Mr. Davis to retain his shares of du Pont stock and thereby to preserve his position and earning capacity with the du Pont company.

21. On March 21, 1955, Mr. Davis transferred to Mrs. Davis 500 shares of du Pont common stock pursuant to the terms of the property settlement agreement.

22. On or before April 15, 1956, plaintiffs filed their joint Federal income tax return for the calendar year 1955 with the District Director of Internal Revenue for Delaware. Such return showed taxable income of $276,374.43 and net tax payable to $202,014.52. The latter amount was duly paid on or before April 15, 1956.

In this 1955 return, plaintiffs claimed as a deduction legal fees in the amount of $5,000. These legal fees were the two payments of $2,500 each, one made to Mr. Young and the other to Mr. Morford, as related in finding 19, covering the respective unpaid balances on the bills of the attorneys for tax services in connection with the separation and property settlement agreement. The plaintiffs did not include as deductions the other legal fees of $5,006 paid to Mr. Young, and $2,500 paid to Mr. Morford, on January 27, 1955.

23. In connection with the audit of plaintiffs' income tax return for 1955, the agent of the Internal Revenue Service proposed to assess a tax deficiency in the sum of $6,318.66 on the basis of disallowance of the deduction of $5,000 for legal fees and on the basis of including in plaintiffs' gross income a net long-term capital gain of $3,737.21, representing the difference between tax basis to Mr. Davis of the 500 shares of du Pont stock transferred to Alice M. Davis during 1955 and the fair market value of such shares as of the date of the transfer to her.

Mr. Davis had a cost basis of $74,775.37 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955. This stock had a fair market value on that date of $82,250, or an increase in value over the cost basis of $7,474.63, one-half of which gain, or $3,737.31, was taken into account in the proposed deficiency assessment.

24. On February 14, 1958, Mr. Davis paid to the District Director the amount of $6,961.95, representing the asserted deficiency for 1955 in the amount of $6,318.66 plus interest of $643.29.

25. On April 8, 1958, plaintiffs filed their claim for refund of Federal income taxes paid for 1955 in the sum of $13,642.29. This claim was based on the failure to include all of the $12,506 of legal fees paid by Mr. Davis to Mr. Young and Mr. Morford on January 27, 1955, as related in finding 19. Plaintiffs asserted in their claim that $2,500 was on that date paid to each attorney, or a total of $5,000, for legal services in connection with various Federal tax matters arising out of negotiations and execution of the separation and property settlement agreement. Plaintiffs further asserted that additional sums as legal fees, $5,006 to Mr. Young and $2,500 to Mr. Morford, were paid on January 27, 1955, for services in connection with the negotiations and execution of the same agreement, primarily incurred in connection with the protection of Mr. Davis' position as a stockholder, officer, and director of du Pont.

This claim further asserted that the inclusion in income of the net long-term capital gain of $3,737.31 on the 500 shares of du Pont stock transferred to Alice M. Davis on March 21, 1955, was erroneous, because such transfer was pursuant to the same separation and property division agreement and did not result in any income or gain to the taxpayer.

26. By registered letter dated September 23, 1958, the District Director of Internal Revenue for Delaware notified plaintiffs of the disallowance in full of their claim for refund for the year 1955.

## Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment will be entered to that effect.

The amount of recovery will be determined pursuant to rule 38(c) of the rules of this court.

## Order.

On March 1, 1961, the court rendered an opinion together with findings of fact, holding that the plaintiffs were entitled to recover and entering judgment to that effect. The determination of the amount of recovery was reserved pending further proceedings pursuant to Rule 38(c).

On April 6, 1961, the commissioner of this court filed a memorandum report recommending that, in accordance with the opinion of the court, judgment be entered for the plaintiffs in the sum of $4,510.45, together with interest thereon from February 14, 1958, as provided by law.

Now, Therefore, It Is Ordered this fourteenth day of April, 1961, that judgment be and the same is entered for the plaintiffs in the sum of four thousand five hundred ten dollars and forty-five cents ($4,510.45), together with interest thereon from February 14, 1958, as provided by law.

BY THE COURT,

/s/ Samuel E. Whitaker,
Samuel E. Whitaker,
*Acting Chief Judge.*

No. 268

# In the Supreme Court of the United States

OCTOBER TERM, 1961

---

THOMAS CRAWLEY DAVIS and GRACE ETHEL DAVIS, PETITIONERS

*v.*

UNITED STATES

---

*ON CROSS-PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS*

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**MEMORANDUM FOR THE UNITED STATES**

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ARCHIBALD COX,
*Solicitor General,*

LOUIS F. OBERDORFER,
*Assistant Attorney General,*

MEYER ROTHWACKS,
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*Washington 25, D. C.*

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## MEMORANDUM FOR THE UNITED STATES

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The United States has petitioned for certiorari on one of the issues decided by the Court of Claims in this case.[1] This cross-petition is directed to another issue—whether a husband may take an income tax deduction for fees which he undertook to pay to the

[1] *United States* v. *Thomas Crawley Davis and Grace Ethel Davis*, No. 190, this Term. The question there presented is whether a husband realizes taxable income when he transfers to his divorced wife, in return for the release of her marital claims, assets which have appreciated in value during his ownership.

attorney of his divorced wife for tax advice which she received incident to the property settlement. Both of the issues are outgrowths of a marital dispute between Thomas Crawley Davis (the taxpayer) and his former wife,[2] which culminated in a divorce and property settlement. The issues are otherwise unrelated and turn on different legal principles. Consequently, consideration of the question raised in the government's *Davis* petition, should it be granted, would not be aided by grant of this cross-petition. Nevertheless, because of other considerations, we do not oppose the cross-petition.

The issue raised in the cross-petition presents an aspect of a broad question which has engendered conflict and confusion in the lower federal courts. That question, stated in generalized form, is the deductibility, for income tax purposes, of legal expenses arising out of divorce proceedings. The government has recently filed two petitions in two of these "fee" cases—*United States* v. *Gilmore,* No. 255, and *United States* v. *Patrick,* No. 256. The issue takes various forms, of which the following are examples:

(1) The deductibility of legal fees for services in obtaining the divorce itself. These are generally conceded to be non-deductible personal expenses.[3]

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[2] His present wife is a party to this proceeding because a joint return was filed for 1955.

[3] Under Section 262 of the Internal Revenue Code of 1954, which provides that "no deduction shall be allowed for personal, living, or family expenses."

(2) The deductibility of legal fees for services rendered the husband in contesting the wife's claims to a portion of his property. With few exceptions such fees have also been held to be non-deductible. One of the exceptions is the decision of the Court of Claims in *Gilmore* v. *United States*, now pending on the government's petition for a writ of certiorari (No. 255).

(3) The deductibility of legal fees for services in working out or effectuating a property settlement. The Second Circuit has held that such fees are non-deductible personal expenses. *Lewis* v. *Commissioner*, 253 F. 2d 821, relying on *Lykes* v. *United States*, 343 U.S. 118. The Fourth Circuit recently held to the contrary, *United States* v. *Patrick*, 288 F. 2d 292, pending on the government's petition (No. 256), allowing a husband to deduct, under Section 212(2) of the Internal Revenue Code of 1954,[4] both fees which he paid to his own attorney and those which he paid to his wife's lawyer.

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[4] Section 212 is as follows:

SEC. 212. EXPENSES FOR PRODUCTION OF INCOME

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

(26 U.S.C. 1958 ed., Sec. 212.)

(4) The deductibility of legal fees for tax advice rendered in connection with a property settlement. The court below dealt with the question of the deductibility of such fees, under subsection (3) of Section 212, in two aspects—deductibility of the fee paid by the husband to his own attorney and of the fee paid by the husband to his wife's attorney for the tax advice which she received. It allowed the first and disallowed the second. Its disallowance of the fee paid by the husband to the wife's attorney is the occasion for the cross-petition.[5]

In our view, all of the above legal expenses are primarily personal and do not fall within any of the Code's deduction provisions. Some of the lower courts, however, as indicated above, have drawn distinctions, allowing the deduction in some instances but not in others. The precise issue raised in the cross-petition is not, at the present time, the subject of conflict between the circuits. Should this Court, however, grant certiorari in the *Gilmore* and *Patrick* cases (both of which do involve conflict), it might deem it appropriate to consider at the same time,

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[5] The government did not petition for certiorari on the allowance of the fee paid to the husband's attorney because there was no direct conflict.

the somewhat related issue presented by the cross-petition.[6]

Respectfully submitted,

ARCHIBALD COX,
*Solicitor General.*

LOUIS F. OBERDORFER,
*Assistant Attorney General.*

MEYER ROTHWACKS,
HAROLD C. WILKENFELD,
*Attorneys.*

SEPTEMBER 1961.

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[6] We say "somewhat related" because, as noted above, the claim for a deduction in *Gilmore* and *Patrick* is rested on Section 212(2); here, it is based on Section 212(3). Moreover, the claim here is an extreme one, since the husband is seeking to take a deduction for tax counseling received by the wife. We question (1) whether the deduction is of a type encompassed by Section 212(3), and (2) whether, in any event, the deduction could be shifted to the husband by agreement of the parties (see *Magruder* v. *Supplee*, 316 U.S. 394, 399).

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# SUPREME COURT OF THE UNITED STATES

Nos. 190 and 268.—October Term, 1961.

| | |
|---|---|
| United States, Petitioner, 190 *v.* Thomas Crawley Davis et al. | On Writs of Certiorari to the United States Court of Claims. |
| Thomas Crawley Davis et al., Petitioners, 268 *v.* United States. | |

[June 4, 1962.]

Mr. Justice Clark delivered the opinion of the Court.

These cases involve the tax consequences of a transfer of appreciated property by Thomas Crawley Davis [1] to his former wife pursuant to a property settlement agreement executed prior to divorce, as well as the deductibility of his payment of her legal expenses in connection therewith. The Court of Claims upset the Commissioner's determination that there was taxable gain on the transfer but upheld his ruling that the fees paid the wife's attorney were not deductible. 287 F. 2d 168. We granted certiorari on a conflict in the Courts of Appeals and the Court of Claims on the taxability of such transfers.[2] 368 U. S. 813. We have decided that the taxpayer did have a taxable gain on the transfer and that the wife's attorney's fees were not deductible.

In 1954 the taxpayer and his then wife made a voluntary property settlement and separation agreement calling

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[1] Davis' present wife, Grace Ethel Davis, is also a party to these proceedings because a joint return was filed in the tax year in question.

[2] The holding in the instant case is in accord with *Commissioner* v. *Marshman,* 279 F. 2d 27 (C. A. 6th Cir. 1960), but is contra to the holdings in *Commissioner* v. *Halliwell,* 131 F. 2d 642 (C. A. 2d Cir. 1942), and *Commissioner* v. *Mesta,* 123 F. 2d 986 (C. A. 3d Cir. 1941).

for support payments to the wife and minor child in addition to the transfer of certain personal property to the wife. Under Delaware law all the property transferred was that of the taxpayer, subject to certain statutory marital rights of the wife including a right of intestate succession and a right upon divorce to a share of the husband's property.[3] Specifically as a "division in settlement of their property" the taxpayer agreed to transfer to his wife, *inter alia,* 1,000 shares of stock in the E. I. du Pont de Nemours & Co. The then Mrs. Davis agreed to accept this division "in full settlement and satisfaction of any and all claims and rights against the husband whatsoever (including but not by way of limitation, dower and all rights under the laws of testacy and intestacy) . . . ." Pursuant to the above agreement which had been incorporated into the divorced decree, one-half of this stock was delivered in the tax year involved, 1955, and the balance thereafter. Respondent's cost basis for the 1955 transfer was $74,775.37, and the fair market value of the 500 shares there transferred was $82,250. The taxpayer also agreed orally to pay the wife's legal expenses, and in 1955 he made payments to the wife's attorney, including $2,500 for services concerning tax matters relative to the property settlement.

I.

The determination of the income tax consequences of the stock transfer described above is basically a two-step analysis: (1) Was the transaction a taxable event? (2) If so, how much taxable gain resulted therefrom? Originally the Tax Court (at that time the Board of Tax Appeals) held that the accretion to property transferred pursuant to a divorce settlement could not be taxed as capital gain to the transferor because the amount realized

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[3] 12 Del. Code Ann. (Supp. 1960) § 512; 13 Del. Code Ann. § 1531. In the case of realty, the wife in addition to the above has rights of dower. 12 Del. Code Ann. §§ 502, 901, 904, 905.

by the satisfaction of the husband's marital obligations was indeterminable and because, even if such benefit were ascertainable, the transaction was a nontaxable division of property. *Mesta* v. *Commissioner*, 42 B. T. A. 933 (1940); *Halliwell* v. *Commissioner*, 44 B. T. A. 740 (1941). However, upon being reversed in quick succession by the Courts of Appeals of the Third and Second Circuits, *Commissioner* v. *Mesta*, 123 F. 2d 986 (C. A. 3d Cir. 1941); *Commissioner* v. *Halliwell*, 131 F. 2d 642 (C. A. 2d Cir. 1942), the Tax Court accepted the position of these courts and has continued to apply these views in appropriate cases since that time. *Hall* v. *Commissioner*, 9 T. C. 53 (1947); *Patino* v. *Commissioner*, 13 T. C. 816 (1949); *Estate of Stouffer*, 30 T. C. 1244 (1958); *King* v. *Commissioner*, 31 T. C. 108 (1958); *Marshman* v. *Commissioner*, 31 T. C. 269 (1958). In *Mesta* and *Halliwell* the Courts of Appeals reasoned that the accretion to the property was "realized" by the transfer and that this gain could be measured on the assumption that the relinquished marital rights were equal in value to the property transferred. The matter was considered settled until the Court of Appeals for the Sixth Circuit, in reversing the Tax Court, ruled that, although such a transfer might be a taxable event, the gain realized thereby could not be determined because of the impossibility of evaluating the fair market value of the wife's marital rights. *Commissioner* v. *Marshman*, 279 F. 2d 27 (1960). In so holding that court specifically rejected the argument that these rights could be presumed to be equal in value to the property transferred for their release. This is essentially the position taken by the Court of Claims in the instant case.

II.

We now turn to the threshold question of whether the transfer in issue was an appropriate occasion for taxing the accretion to the stock. There can be no doubt

that Congress, as evidenced by its inclusive definition of income subject to taxation, *i. e.*, "all income from whatever source derived, including . . . [g]ains derived from dealings in property,"[4] intended that the economic growth of this stock be taxed. The problem confronting us is simply *when* is such accretion to be taxed. Should the economic gain be presently assessed against taxpayer, or should this assessment await a subsequent transfer of the property by the wife? The controlling statutory language, which provides that gains from dealings in property are to be taxed upon "sale or other disposition,"[5] is too general to include or exclude conclusively the transaction presently in issue. Recognizing this, the Government and the taxpayer argue by analogy from transactions more easily classified as within or without the ambient of taxable events. The taxpayer asserts that the present disposition is comparable to a nontaxable division of property between two co-owners,[6] while the

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[4] Internal Revenue Code of 1954 § 61 (a).

[5] Internal Revenue Code of 1954 §§ 1001, 1002.

[6] Any suggestion that the transaction in question was a gift is completely unrealistic. Property transferred pursuant to a negotiated settlement in return for the release of admittedly valuable rights is not a gift in any sense of the term. To intimate that there was a gift to the extent the value of the property exceeded that of the rights released not only invokes the erroneous premise that every exchange not precisely equal involves a gift but merely raises the measurement problem discussed in Part III, *infra*, p. —. Cases in which this Court has held transfers of property in exchange for the release of marital rights subject to gift taxes are based not on the premise that such transactions are inherently gifts but on the concept that in the contemplation of the gift tax statute they are to be taxed as gifts. *Merrill* v. *Fahs*, 324 U. S. 308 (1945); *Commissioner* v. *Wemyss*, 324 U. S. 303 (1945); see *Harris* v. *Commissioner*, 340 U. S. 106 (1950). In interpreting the particular income tax provisions here involved, we find ourselves unfettered by the language and considerations ingrained in the gift and estate tax statutes. See *Farid-Es-Sultaneh* v. *Commissioner*, 160 F. 2d 812 (C. A. 2d Cir. 1947).

Government contends it more resembles a taxable transfer of property in exchange for the release of an independent legal obligation. Neither disputes the validity of the other's starting point.

In support of his analogy the taxpayer argues that to draw a distinction between a wife's interest in the property of her husband in a common-law jurisdiction such as Delaware and the property interest of a wife in a typical community property jurisdiction would commit a double sin; for such differentiation would depend upon "elusive and subtle casuistries which . . . possess no relevance for tax purposes," *Helvering* v. *Hallock*, 309 U. S. 106, 118 (1940), and would create disparities between common-law and community property jurisdictions in contradiction to Congress' general policy of equality between the two. The taxpayer's analogy, however, stumbles on its own premise, for the inchoate rights granted a wife in her husband's property by the Delaware law do not even remotely reach the dignity of co-ownership. The wife has no interest—passive or active—over the management or disposition of her husband's personal propetry. Her rights are not descendable, and she must survive him to share in his intestate estate. Upon dissolution of the marriage she shares in the property only to such extent as the court deems "reasonable." 13 Del. Code Ann. § 1531 (a). What is "reasonable" might be ascertained independent of the extent of the husband's property by such criteria as the wife's financial condition, her needs in relation to her accustomed station in life, her age and health, the number of children and their ages, and the earning capacity of the husband. See, *e. g.*, *Beres* v. *Beres*, 52 Del. 133, 154 A. 2d 384 (1959).

This is not to say it would be completely illogical to consider the shearing off of the wife's rights in her husband's property as a division of that property, but we believe the contrary to be the more reasonable construc-

tion. Regardless of the tags, Delaware seems only to place a burden on the husband's property rather than to make the wife a part owner thereof. In the present context the rights of succession and reasonable share do not differ significantly from the husband's obligations of support and alimony. They all partake more of a personal liability to the husband than a property interest of the wife. The effectuation of these marital rights may ultimately result in the ownership of some of the husband's property as it did here, but certainly this happenstance does not equate the transaction with a division of property by co-owners. Although admittedly such a view may permit different tax treatment among the several States, this Court in the past has not ignored the differing effects on the federal taxing scheme of substantive differences between community property and common-law systems. *E. g., Poe* v. *Seaborn,* 282 U. S. 101 (1930). To be sure Congress has seen fit to alleviate this disparity in many areas, *e. g.,* Revenue Act of 1948, 62 Stat. 110, but in other areas the facts of life are still with us.

Our interpretation of the general statutory language is fortified by the long-standing administrative practice as sounded and formalized by the settled state of law in the lower courts. The Commissioner's position was adopted in the early 40's by the Second and Third Circuits and by 1947 the Tax Court had acquiesced in this view. This settled rule was not disturbed by the Court of Appeals for the Sixth Circuit in 1960 or the Court of Claims in the instant case, for these latter courts in holding the gain indeterminable assumed that the transaction was otherwise a taxable event. Such unanimity of views in support of a position representing a reasonable construction of an ambiguous statute will not lightly be put aside. It is quite possible that this notorious construction was relied upon by numerous taxpayers as well as the

Congress itself, which not only refrained from making any changes in the statutory language during more than a score of years but re-enacted this same language in 1954.

III.

Having determined that the transaction was a taxable event, we now turn to the point on which the Court of Claims balked, *viz.*, the measurement of the taxable gain realized by the taxpayer. The Code defines the taxable gain from the sale or disposition of property as being the "excess of amount realized therefrom over the adjusted basis . . . ." I. R. C. (1954) § 1001 (a). The "amount realized" is further defined as "the sum of any money received plus the fair market value of the property (other than money) received." I. R. C. (1954) § 1001 (b). In the instant case the "property received" was the release of the wife's inchoate marital rights. The Court of Claims, following the Court of Appeals for the Sixth Circuit, found that there was no way to compute the fair market value of these marital rights and that it was thus impossible to determine the taxable gain realized by the taxpayer. We believe this conclusion was erroneous.

It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged. There was no evidence to the contrary here. Absent a readily ascertainable value it is accepted practice where property is exchanged to hold, as did the Court of Claims in *Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189 (1954), that the values "of the two properties exchanged in an arm's-length transaction are either equal in fact, or are presumed to be equal." Accord, *United States* v. *General Shoe Corp.,* 282 F. 2d 9 (C. A. 6th Cir. 1960); *International Freighting Corp.* v. *Commissioner,* 135 F. 2d 310 (C. A. 2d Cir. 1943). To be sure there is much to

be said of the argument that such an assumption is weakened by the emotion, tension and practical necessities involved in divorce negotiations and the property settlements arising therefrom. However, once it is recognized that the transfer was a taxable event, it is more consistent with the general purpose and scheme of the taxing statutes to make a rough approximation of the gain realized thereby than to ignore altogether its tax consequences. Cf. *Helvering* v. *Safe Deposit & Trust Co.*, 316 U. S. 56, 67 (1942).

Moreover, if the transaction is to be considered a taxable event as to the husband, the Court of Claims' position leaves up in the air the wife's basis for the property received. In the context of a taxable transfer by the husband,[7] all indicia point to a "cost" basis for this property in the hands of the wife.[8] Yet under the Court of Claims' position her cost for this property, *i. e.*, the value of the marital rights relinquished therefor, would be indeterminable, and on subsequent disposition of the property she might suffer inordinately over the Commissioner's assessment which she would have the burden of proving erroneous, *Commissioner* v. *Hansen*, 360 U. S. 446, 468 (1959). Our present holding that the value of these rights is ascertainable eliminates this problem; for the

[7] Under the present administrative practice, the release of marital rights in exchange for property or other consideration is not considered a taxable event as to the wife. For a discussion of the difficulties confronting a wife under a contrary approach, see Taylor and Schwartz, Tax Aspects of Marital Property Agreements, 7 Tax L. Rev. 19, 30 (1951); Comment, The Lump Sum Divorce Settlement as a Taxable Exchange, 8 U. C. L. A. L. Rev. 593, 601–602 (1961).

[8] Section 1012 of the Internal Revenue Code of 1954 provides that: "The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). . . ."

same calculation that determines the amount received by the husband fixes the amount given up by the wife, and this figure, *i. e.*, the market value of the property transferred by the husband, will be taken by her as her tax basis for the property received.

Finally, it must be noted that here, as well as in relation to the question of whether the event is taxable, we draw support from the prior administrative practice and judicial approval of that practice. See p. —, *supra*. We therefore conclude that the Commissioner's assessment of a taxable gain based upon the value of the stock at the date of its transfer has not been shown erroneous.[9]

IV.

The attorney-fee question is much simpler. It is the customary practice in Delaware for the husband to pay both his own and his wife's legal expenses incurred in the divorce and the property settlement. Here petitioner paid $5,000 of such fees in the taxable year 1955 earmarked for tax advice in relation to the property settlement. One-half of this sum went to the wife's attorney. The taxpayer claimed that under § 212 (3) of the 1954 Code, which allows a deduction for the "ordinary and necessary expenses paid . . . in connection with the determination, collection, or refund of any tax," he was entitled to deduct the entire $5,000. The Court of Claims allowed the $2,500 paid taxpayer's own attorney but denied the like amount paid the wife's attorney. The sole question here is the deductibility of the latter fee; the Government did not seek review of the amount taxpayer paid his own attorney, and we intimate no decision on that point. As to the deduction of the wife's fees, we read the statute, if applicable to this type of tax expense,

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[9] We do not pass on the soundness of the taxpayer's other attacks upon this determination, for these contentions were not presented to the Commissioner or the Court of Claims.

to include only the expenses of the taxpayer himself and not those of his wife. Here the fees paid her attorney do not appear to be "in connection with the determination, collection, or refund" of any tax of the taxpayer. As the Court of Claims found, the wife's attorney "considered the problems from the standpoint of his client alone. Certainly then it cannot be said that . . . [his] advice was directed to plaintiff's tax problems . . . ." 287 F. 2d, at 171. We therefore conclude, as did the Court of Claims, that those fees were not a deductible item to the taxpayer.

*Reversed in part and affirmed in part.*

MR. JUSTICE FRANKFURTER took no part in the decision of these cases.

MR. JUSTICE WHITE took no part in the consideration or decision of these cases.